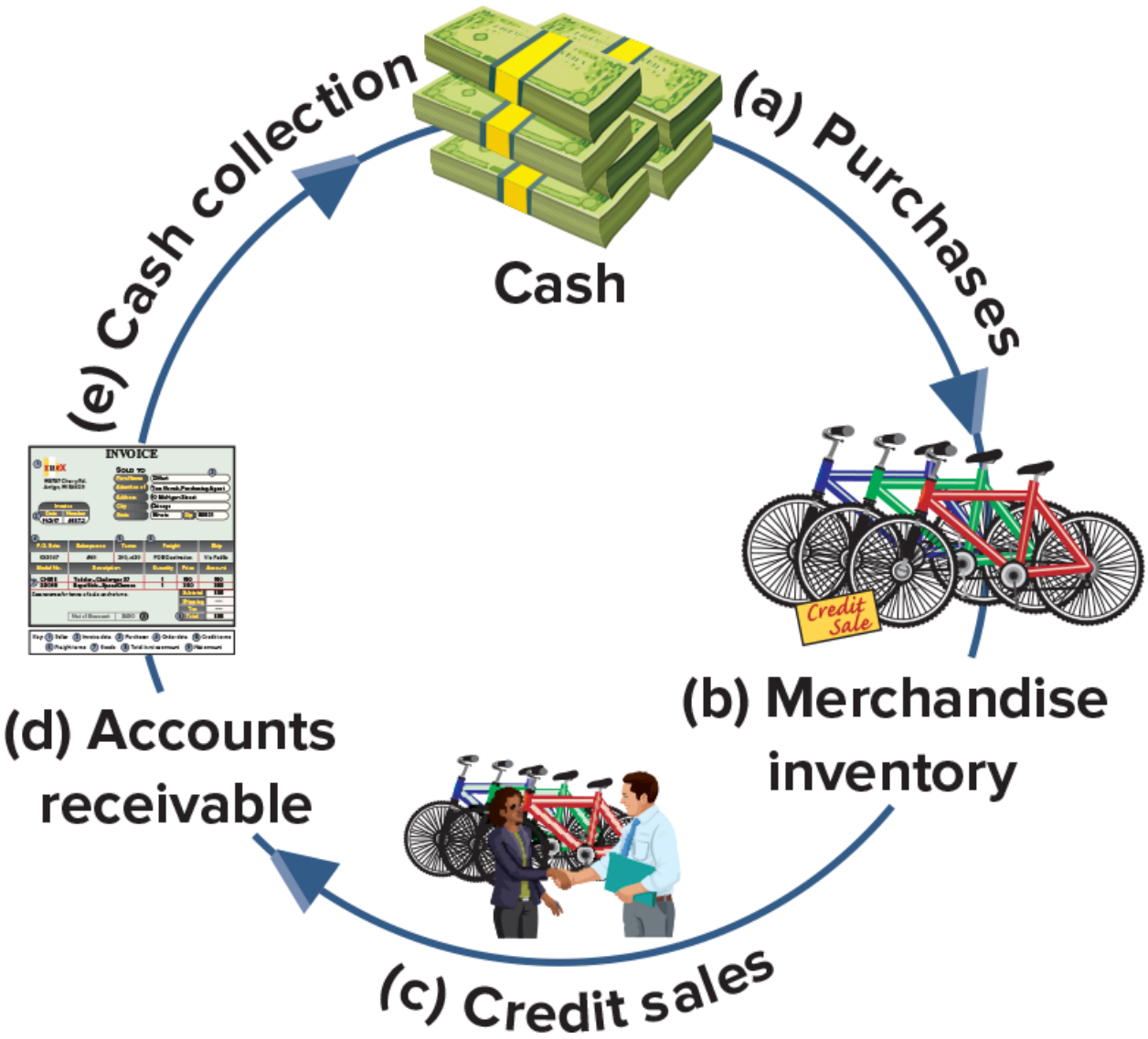
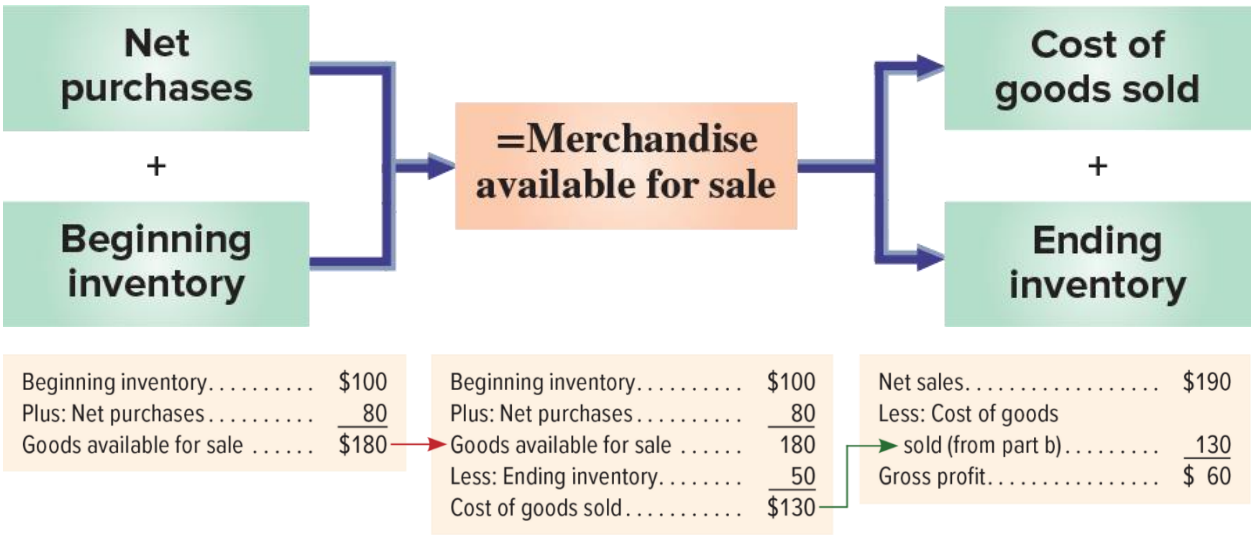
Page 164 5 Accounting for Merchandising Operations Chapter Preview MERCHANDISING ACTIVITIES C1Income and inventory for merchandisers Operating cycle Inventory cost flows NTK 5-1 MERCHANDISING PURCHASES P1Accounting for: Purchases discounts Purchases returns and allowances Transportation costs NTK 5-2 MERCHANDISING SALES P2Accounting for: Sales of merchandise Sales discounts Sales returns and allowances NTK 5-3 MERCHANDISER REPORTING P3Adjusting and closing P4Multiple-step and single-step income statements A1Acid-test analysis Gross margin analysis NTK 5-4, 5-5 All content is consistent with new revenue recognition rules. Details of new adjusting entries are in Appendix 5B. Learning Objectives CONCEPTUAL C1Describe merchandising activities and cost flows. ANALYTICAL A1Compute and analyze the acid-test ratio and gross margin ratio. PROCEDURAL P1Analyze and record transactions for merchandise purchases using a perpetual system. P2Analyze and record transactions for merchandise sales using a perpetual system. P3Prepare adjustments and close accounts for a merchandising company. P4Define and prepare multiple-step and single-step income statements. P5Appendix 5A—Record and compare merchandising transactions using both periodic and perpetual inventory systems. P6Appendix 5B—Prepare adjustments for discounts, returns, and allowances per revenue recognition rules. P7Appendix 5C—Record and compare merchandising transactions using the gross method and net method. Page 165 State of the Art “Go big or go home” —Kendra Scott AUSTIN, TX—Kendra Scott took $500 from savings and designed her first jewelry collection from her bedroom. “My mom’s family was farmers and coal miners,” says Kendra. “They were very hardworking folks.” She applied that same work ethic to her passion for design and business. Today, Kendra Scott (KendraScott.com) jewelry and accessories are available from over 600 stores. Kendra has opened 75 of her own stores. “I’m a girl from Kenosha, Wisconsin,” points out Kendra. “Who would’ve thought I’d be a fashion designer?” Although Kendra has a knack for fashion, she attributes much of her company’s success to an ability to analyze trends in customer tastes. Kendra regularly applies accounting analytics to sales, purchases, and inventory data. This allows her to see which products are selling well and which are piling up in inventory. According to Kendra, analyzing accounting data and engaging with customers enable the company to “hear what [the customer] wants, what she needs, and what’s important to her.” Her company’s accounting reports detail sales and gross profit information to help Kendra assess business and new opportunities. Those reports also help Kendra gauge how much she can devote to charity. “I decided that if someone would call me for a charitable donation . . . I would always have something to give,” insists Kendra. “We don’t turn anyone away.” Jarod Gibo Kendra explains that accounting, merchandising, and fashion are a perfect blend. She admits, “I feel like the luckiest person alive.” Sources: Kendra Scott website, January 2021; Success.com, March 2016; CBS, March 2018

Service Company

Merchandiser





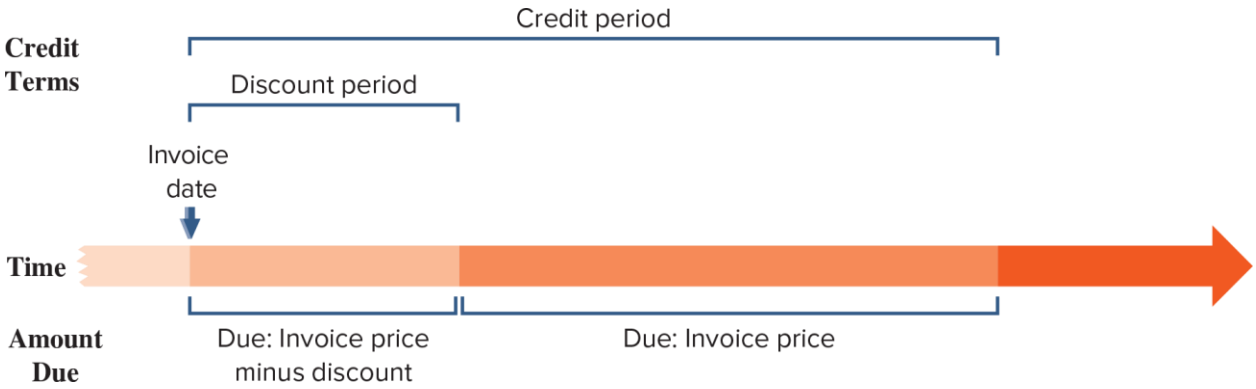
MERCHANDISE PURCHASES This section explains how we record purchases under different purchase terms. P1 Analyze and record transactions for merchandise purchases using a perpetual system. Purchases without Cash Discounts Z-Mart records a $500 cash purchase of merchandise on November 2 as follows. Table Summary: Journal entry with date, account name, and debit amount on first line; indented account name and credit amount on next line; and description on the last line. Nov. 2 Merchandise Inventory 500 Cash 500 Purchased goods for cash. If these goods are instead purchased on credit, Z-Mart makes the same entry except that Accounts Payable is credited instead of Cash. Purchases with Cash Discounts The purchase of goods on credit requires credit terms. Credit terms include the amounts and timing of payments from a buyer to a seller. To demonstrate, when sellers require payment within 60 days after the invoice date, credit terms are “n/60,” meaning net 60 days. Page 168 Credit Terms Exhibit 5.5 explains credit terms. The amount of time allowed before full payment is due is the credit period. Sellers can grant a cash discount to encourage buyers to pay earlier. A buyer views a cash discount as a purchases discount. A seller views a cash discount as a sales discount. Any cash discounts are described on the invoice. The invoice date sets the discount and credit periods. For example, credit terms of “2/10, n/60” mean that full payment is due within a 60-day credit period, but the buyer can deduct 2% of the invoice amount if payment is made within 10 days of the invoice date. This reduced payment is only for the discount period. EXHIBIT 5.5 Credit Terms Invoice On November 2, Z-Mart purchases $500 of merchandise on credit with terms of 2/10, n/30. The invoice for this purchase is shown in Exhibit 5.6. This is a purchase invoice for Z-Mart (buyer) and a sales invoice for Trex (seller). The amount recorded for merchandise inventory includes its purchase cost, shipping fees, taxes, and any other costs necessary to make it ready for sale. EXHIBIT 5.6 Invoice Gross

Method Z-Mart purchases $500 of merchandise on credit terms of 2/10, n/30. The November 2 invoice offers a 2% discount if paid within 10 days; if not, Z-Mart must pay the full amount within 30 days. The buyer has two options. Pay within discount period (Nov. 2 through Nov. 12): Due = $490. or Pay after discount period (Nov. 13 through Dec. 2): Due = $500. The $490 equals the $500 invoice minus $10 discount (computed as $500 × 2%). Page 169 On the purchase date, we do not know if payment will occur within the discount period. The gross method records the purchase at its gross (full) invoice amount. For Z-Mart, the purchase of $500 of merchandise with terms of 2/10, n/30 is recorded at $500. The gross method is used here because it (1) complies with new revenue recognition rules, (2) is used more in practice, and (3) is easier and less costly to apply. Purchases on Credit Z-Mart's entry to record the November 2 purchase of $500 of merchandise on credit follows. (If Z-Mart has multiple suppliers, it helps to add the name to the payable, such as Accounts Payable—Trex.) Table Summary: Journal entry with date, account name, and debit amount on first line; indented account name and credit amount on next line; and description on the last line. (a) Nov. 2 Merchandise Inventory 500 Accounts Payable 500 Purchased goods, terms 2/10, n/30. Point: Appendix 5A repeats journal entries a through g using the periodic system. Payment within Discount Period Good cash management means that invoices are not paid until the last day of the discount or credit period. This is because the buyer can use that money until payment is required. If Z-Mart pays the amount due on or before November 12, the entry is Table Summary: Journal entry with date, account name, and debit amount on first line; indented account names and credit amount on second and third line; and description on the last line. (b1) Nov. 12 Accounts Payable 500 Merchandise Inventory 10 Cash* 490 Paid for goods within discount period. *$500 × (100% – 2%) The Merchandise Inventory account equals the $490 net cost of purchases after these entries, and the Accounts Payable account has a zero balance. Table Summary: T-account with one debit entry, one credit entry, and a credit balance. /T-account with one debit entry, one credit entry, and a debit balance./ T-account with one credit entry. Accounts Payable Nov. 12 500 Nov. 2 500 Bal. 0 Table Summary: T-account with one debit entry, one credit entry, and a credit balance. /T-account with one debit entry, one credit entry, and a debit balance./ T-account with one credit entry. Merchandise Inventory Nov. 2 500 Nov. 12 10 Bal. 490 Table Summary: T-account with one debit entry, one credit entry, and a credit balance. /T-account with one debit entry, one credit entry, and a debit balance./ T-account with one credit entry. Cash Nov. 12 490 Payment after Discount Period If the invoice is paid after November 12, the discount is lost. If Z-Mart pays the gross (full) amount due on December 2 (the n/30 due date), the entry is Table Summary: Journal entry with date, account name, and debit amount on first line; indented account name and credit amount on next line; and description on the last line. (b2) Dec. 2 Accounts Payable

500 Cash 500 Paid for goods outside discount period. Purchases with Returns and Allowances Purchases returns are merchandise a buyer purchases but then returns. Purchases allowances refer to a seller granting a price reduction (allowance) to a buyer of defective or unacceptable merchandise. Purchases Allowances On November 5, Z-Mart (buyer) agrees to a $30 allowance from Trex for defective merchandise (assume allowance is $30 whether paid within the discount period or not). Z-Mart's entry to update Merchandise Inventory and record the allowance follows. Z-Mart's allowance for defective merchandise reduces its account payable to the seller. If cash is refunded, Cash is debited instead of Accounts Payable. Table Summary: Journal entry with date, account name, and debit amount on first line; indented account name and credit amount on next line; and description on the last line. (c1) Nov. 5 Accounts Payable 30 Merchandise Inventory 30 Allowance for defective goods. Purchases Returns Returns of inventory are recorded at the amount charged for that inventory. On June 1, Z-Mart purchases $250 of merchandise with terms 2/10, n/60—see entries below. On June 3, Z-Mart returns $50 of those goods. When Z-Mart pays on June 11, it takes the 2% discount only on the $200 remaining balance ($250 − $50). When goods are returned, a buyer takes a discount on only the remaining balance. This means the discount is $4 (computed as $200 × 2%) and the cash payment is $196 (computed as $200 − $4). Page 170 Table Summary: Journal entries with date, account name, and debit amount on first line; indented account name and credit amount on next line; and description on the final line of entry. Entry for June 11 has two credited accounts. June 1 Merchandise Inventory 250 Accounts Payable 250 Purchased goods, terms 2/10, n/60. (c2) June 3 Accounts Payable 50 Merchandise Inventory 50 Returned goods to seller. June 11 Accounts Payable 200 Merchandise Inventory 4 Cash 196 Paid for $200 of goods less $4 discount. These T-accounts show the final $196 in inventory, the zero balance in Accounts Payable, and the $196 cash payment. Table Summary: T-account with two debit entries, one credit entry, and a credit balance./ T-account with one debit entry, two credit entries, and a debit balance./ T-account with one credit entry. Accounts Payable Jun. 3 Jun. 11 50 200 Jun. 1 250 Bal. 0 Table Summary: T-account with two debit entries, one credit entry, and a credit balance./ T-account with one debit entry, two credit entries, and a debit balance./ T-account with one credit entry. Merchandise Inventory Jun. 1 250 Jun. 3 Jun. 11 50 4 Bal. 196 Table Summary: T-account with two debit entries, one credit entry, and a credit balance./ T-account with one debit entry, two credit entries, and a debit balance./ T-account with one credit entry. Cash Jun. 11 196 Example: If, on June 20, Z-Mart returns all goods paid for on June 11, the entry is Cash 196 Merchandise Inventory 196 Purchases and Transportation Costs The buyer and seller must agree on who is responsible for paying freight (shipping) costs and who has the risk of loss during transit. This is the same as asking at what point ownership

transfers from the seller to the buyer. The point of transfer is called the FOB (free on board) point. Exhibit 5.7 covers two alternative points of transfer. EXHIBIT 5.7 Ownership Transfer and Transportation Costs FOB shipping point means the buyer accepts ownership when the goods depart the seller's place of business. The buyer pays shipping costs and has the risk of loss in transit. The goods are part of the buyer's inventory when they are in transit because ownership has transferred to the buyer. 1-800-Flowers.com, a floral merchandiser, uses FOB shipping point. FOB destination means ownership of goods transfers to the buyer when the goods arrive at the buyer's place of business. The seller pays shipping charges and has the risk of loss in transit. The seller does not record revenue until the goods arrive at the destination. When a buyer is responsible for paying transportation costs, the payment is made to a carrier or directly to the seller. The cost principle requires that transportation costs of a buyer (often called transportation-in or freight-in) be part of the cost of merchandise inventory. Z-Mart's entry to record a $75 freight charge from UPS for merchandise purchased FOB shipping point is Table Summary: Journal entry with date, account name, and debit amount on first line; indented account name and credit amount on next line; and description on the last line. (d) Nov. 24 Merchandise Inventory 75 Cash 75 Paid freight costs on goods. Page 171 When a seller is responsible for paying shipping costs, it records these costs in a Delivery Expense account. Delivery expense, also called transportation-out or freight-out, is reported as a selling expense in the seller's income statement. Itemized Costs of Purchases In summary, purchases are recorded as debits to Merchandise Inventory. Purchases discounts, returns, and allowances are credited to (subtracted from) Merchandise Inventory. Transportation-in is debited (added) to Merchandise Inventory. Z-Mart's itemized costs of merchandise purchases for the year are in Exhibit 5.8. EXHIBIT 5.8 Itemized Costs of Merchandise Purchases Itemized Costs of Merchandise Purchases Invoice cost of merchandise purchases $ 235,800 Less: Purchases discounts received (4,200) Purchases returns and allowances (1,500) Add: Costs of transportation-in 2,300 Total net cost of merchandise purchases $232,400 The accounting system described here does not provide separate records (accounts) for total purchases, total purchases discounts, total purchases returns and allowances, and total transportation-in. Many companies collect this information in supplementary records to evaluate these costs. Supplementary records, or supplemental records, refer to information outside the usual ledger accounts. Point: Purchase of inventory affects balance sheet accounts only. Decision Ethics PeopleImages/E+/Getty Images Payables Manager As a new accounts payable manager, you are being trained by the outgoing manager. She explains that the system prepares checks for amounts net of favorable cash discounts, and the checks are dated the last day of the discount period. She tells you that checks are not mailed until five days later, adding that "the company gets free use of cash for an extra five days, and our department looks better." Do you continue this

policy? ■ Answer NEED-TO-KNOW 5-2 Merchandise Purchases P1 Prepare journal entries to record each of the following transactions. Assume a perpetual inventory system using the gross method for recording purchases. Oct. 1 Purchased $1,000 of goods. Terms of the sale are 4/10, n/30, and FOB shipping point; the invoice is dated October 1. 3 Paid $30 cash for freight charges from UPS for the October 1 purchase. 7 Returned $50 of the $1,000 of goods from the October 1 purchase and received full credit. 11 Paid the amount due from the October 1 purchase (less the return on October 7). 31 Assume the October 11 payment was never made. Instead, payment of the amount due, less the return on October 7, occurred on October 31. Solution Table Summary: Journal entries with date, account name, and debit amount on first line; indented account name and credit amount on next line; and description on the final line of entry.; Journal entries with date, account name, and debit amount on first line; indented account name and credit amount on following line; and description on the final line or lines of each entry. Entry for October 11 has two credited accounts and a two-line description. Oct. 1 Merchandise Inventory 1,000 Accounts Payable 1,000 Purchased goods, terms 4/10, n/30. Oct. 3 Merchandise Inventory 30 Cash 30 Paid freight on purchases FOB shipping point. Oct. 7 Accounts Payable 50 Merchandise Inventory 50 Returned goods. Oct. 11 Accounts Payable 950 Merchandise Inventory* 38 Cash† 912 Paid for goods within discount period. *$950 × 4% †$950 − ($950 × 4%) Oct. 31 Accounts Payable‡ 950 Cash 950 Paid for goods outside discount period. ‡$1,000 − $50 Do More: QS 5-4, QS 5-5, QS 5-6, QS 5-7, E 5-3, E 5-4, E 5-5, E 5-8



INVOICE

(1) TROX
W9797 Cherry Rd.
Antigo, WI 54409

(2)

Invoice	
Date	Number
11/2/21	4657-2

SOLD TO (3)

Firm Name	Z-Mart
Attention of	Tom Novak, Purchasing Agent
Address	10 Michigan Street
City	Chicago
State	Illinois — Zip 60521

(4) (5) (6)

P.O. Date	Salesperson	Terms	Freight	Ship
10/30/21	#141	2/10, n/30	FOB Destination	Via FedEx

Model No.	Description	Quantity	Price	Amount
(7) CH015	Toddler–Challenger X7	1	150	150
SD099	Boys/Girls–Speed Demon	1	350	350

See reverse for terms of sale and returns.

Subtotal	500
Shipping	—
Tax	—
(8) Total	500

Net of Discount $490 (9)

Key:
(1) Seller
(2) Invoice date
(3) Purchaser
(4) Order date
(5) Credit terms
(6) Freight terms
(7) Goods
(8) Total invoice amount
(9) Net amount

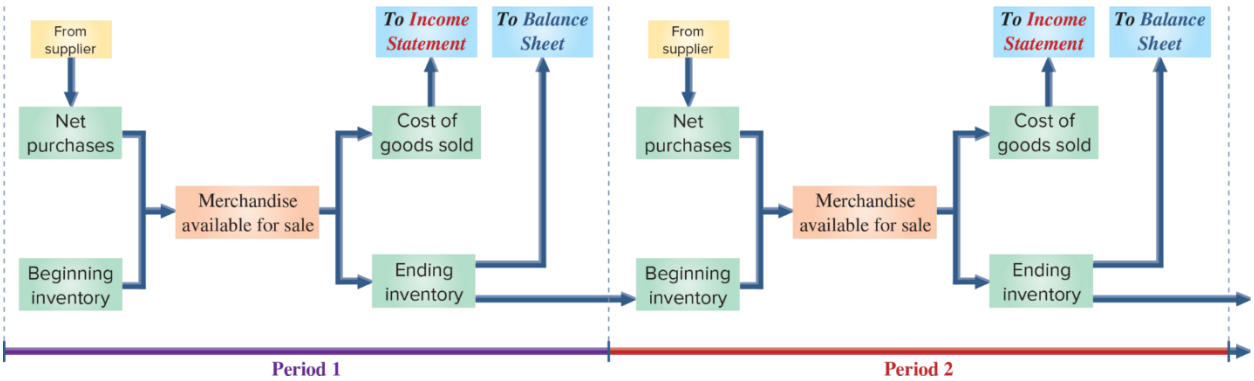
Shipping Terms	Ownership Transfers at	Goods in Transit Owned by	Transportation Costs Paid by
FOB shipping point	Shipping point	Buyer	**Buyer** Merchandise Inventory . . . # Cash . . . . . #
FOB destination	Destination	Seller	**Seller** Delivery Expense . . . . . # Cash . . . . . #

Page 172 MERCHANDISE SALES P2 Analyze and record transactions for merchandise sales using a perpetual system. Merchandising companies must account for sales, sales discounts, sales returns and allowances, and cost of goods sold. Z-Mart has these items in its gross profit computation—see Exhibit 5.9. This shows that customers paid $314,700 for merchandise that cost Z-Mart $230,400, yielding a gross profit of $84,300. EXHIBIT 5.9 Gross Profit Computation Computation of Gross Profit Net sales (net of discounts,

returns, and allowances) $ 314,700 Cost of goods sold 230,400 Gross profit $ 84,300 The perpetual accounting system requires that each sales transaction for a merchandiser, whether for cash or on credit, has two entries: one for revenue and one for cost. Revenue recorded (and asset increased) from the customer. Cost of goods sold incurred (and asset decreased) to the customer. Sales without Cash Discounts Revenue Side: Inflow of Assets Z-Mart sold $1,000 of merchandise on credit terms n/60 on November 12. The revenue part of this transaction is recorded as follows. This entry shows an increase in Z-Mart's assets in the form of accounts receivable. It also shows the increase in revenue (Sales). If the sale is for cash, debit Cash instead of Accounts Receivable. Table Summary: Journal entry with date, account name, and debit amount on first line; indented account name and credit amount on next line; and description on the last line. Nov. 12 Accounts Receivable 1,000 Sales 1,000 Sold goods on credit. [Revenue recognition.] Cost Side: Outflow of Assets The cost side of each sale requires that Merchandise Inventory decrease by that item's cost. The cost of the merchandise Z-Mart sold on November 12 is $300, and the entry to record the cost part of this transaction follows. Point: Gross profit on Nov. 12 sale: Net sales $1,000 Cost of goods sold 300 Gross profit $ 700 Table Summary: Journal entry with date, account name, and debit amount on first line; indented account name and credit amount on next line; and description on the last line. Nov. 12 Cost of Goods Sold 300 Merchandise Inventory 300 Record cost of Nov. 12 sale. [Expense recognition.] Sales with Cash Discounts Offering discounts on credit sales benefits a seller through earlier cash receipts and reduced collection efforts. The gross method records sales at the full amount and records sales discounts if, and when, they are taken. The gross method is used here as it (1) complies with new revenue recognition rules, (2) is used more in practice, and (3) is easier and less costly to apply. (The net method records sales at the net amount, which assumes all discounts are taken. See Appendix 5C.) Sales on Credit Z-Mart makes a credit sale for $1,000 on November 12 with terms of 2/10, n/45 (cost of the merchandise sold is $300). The entries to record this sale follow. Table Summary: Journal entries with date, account name, and debit amount on first line; indented account name and credit amount on next line; and description on the final line of each entry. Nov. 12 Accounts Receivable 1,000 Sales 1,000 Sold goods, terms 2/10, n/45. Nov. 12 Cost of Goods Sold 300 Merchandise Inventory 300 Record cost of Nov. 12 sale. Page 173 Buyer Pays within Discount Period One option is for the buyer to pay $980 within the 10-day discount period ending November 22. The $20 sales discount is computed as $1,000 × 2%. If the customer pays on (or before) November 22, Z-Mart records the cash receipt as follows. Sales Discounts is a contra revenue account, meaning the Sales Discounts account is subtracted from the Sales account when computing net sales. The Sales Discounts account has a normal debit balance because it is subtracted from Sales, which has a normal credit balance. Point: Net sales is the amount received

from the customer. Sales $1,000 Sales discounts (20) Net sales $ 980 Table Summary: Journal entry with date, account name, and debit amount on first two lines; indented account name and credit amount on following line; and description on the final lines of entry. Nov. 22 Cash* 980 Sales Discounts 20 Accounts Receivable 1,000 Received payment on Nov. 12 sale less discount. *$1,000 − ($1,000 × 2%) Buyer Pays after Discount Period The customer's second option is to wait 45 days until December 27 (or at least until after the discount period) and then pay $1,000. Z-Mart records that cash receipt as Table Summary: Journal entry with date, account name, and debit amount on first line; indented account name and credit amount on next line; and description on the last line. Dec. 27 Cash 1,000 Accounts Receivable 1000 Received payment on Nov. 12 sale after discount period. Sales with Returns and Allowances If a customer is unhappy with a purchase, many sellers allow the customer to either return the merchandise for a full refund (sales return) or keep the merchandise along with a partial refund (sales allowance). Buyer Returns Goods—Revenue Side When a buyer returns goods, it impacts the seller's revenue and cost sides. When a return occurs, the seller debits Sales Returns and Allowances, a contra revenue account to Sales. Assume that a customer returns merchandise on December 29 that sold for $15 and cost $9; the revenue-side returns entry is Table Summary: Journal entry with date, account name, and debit amount on first line; indented account name and credit amount on next line; and description on the last line. (e1) Dec. 29 Sales Returns and Allowances 15 Cash 15 Goods returned from Nov. 12 sale. Buyer Returns Goods—Cost Side When a return occurs, the seller must reduce the cost of sales. If the merchandise returned is not defective and can be resold, the seller adds the cost of the returned goods back to inventory and reduces cost of goods sold as follows. (Advanced courses cover cases where goods are defective.) Table Summary: Journal entry with date, account name, and debit amount on first line; indented account name and credit amount on next line; and description on the last line. (e2) Dec. 29 Merchandise Inventory 9 Cost of Goods Sold 9 Returned goods are added back to inventory. Buyer Granted Allowances If a buyer is not satisfied with the goods, the seller might offer a price reduction for the buyer to keep the goods. There is no cost-side entry in this case as the inventory is not returned. On the revenue side, the seller debits Sales Returns and Allowances and credits Cash or Accounts Receivable depending on what's agreed. Assume that $40 of merchandise previously sold is defective. The seller gives a price reduction and credits the buyer's accounts receivable for $10. The seller records this allowance as follows. Page 174 Table Summary: Journal entry with date, account name, and debit amount on first line; indented account name and credit amount on next line; and description on the last line. (f) Nov. 24 Sales Returns and Allowances 10 Accounts Receivable 10 Sales allowance granted. If the seller has already collected cash for the sale, the seller could give the price reduction in cash. For example, instead of crediting the

buyer's Accounts Receivable in the entry above, the seller can credit Cash for $10. Decision Insight Michael DeYoung/Blend Images What's Your Policy? Return policies are a competitive advantage for businesses. REI offers a 1-year return policy on nearly every product it sells. Amazon picks up returned items at your door. On the other hand, some stores like Best Buy allow only 14 days to return products. ■ NEED-TO-KNOW 5-3 Merchandise Sales P2 Prepare journal entries to record each of the following transactions. Assume a perpetual inventory system and use of the gross method. Beginning inventory equals $9,000. June 1 Sold 50 units of merchandise to a customer for $150 per unit under credit terms of 2/10, n/30, FOB shipping point, and the invoice is dated June 1. The 50 units of merchandise had cost $100 per unit. 7 The customer returns 2 units purchased on June 1 because those units did not fit its needs. The seller restores those units to its inventory (as they are not defective) and credits Accounts Receivable from the customer. 11 The seller receives the balance due from the June 1 sale to the customer less returns and allowances. 14 The customer discovers that 10 units have minor damage but keeps them because the seller sends a $50 cash payment allowance to compensate. Solution Table Summary: Journal entries with date, account name, and debit amount on initial line; indented account name and credit amount on following line; and description on the final line of each entry. Entry for June 11 has two debited accounts. June 1 Accounts Receivable 7,500 Sales 7,500 Sold goods. 50 units × $150 June 1 Cost of Goods Sold 5,000 Merchandise Inventory 5,000 Cost of sale. 50 units × $100 June 7 Sales Returns and Allowances 300 Accounts Receivable 300 Returns accepted. 2 units × $150 June 7 Merchandise Inventory 200 Cost of Goods Sold 200 Returns to inventory. 2 units × $100 June 11 Cash 7,056 Sales Discounts* 144 Accounts Receivable 7,200 Received payment. *($7,500 – $300) × 2% June 14 Sales Returns and Allowances 50 Cash 50 Recorded allowance on goods. Do More: QS 5-10, QS 5-11, QS 5-12, QS 5-13, E 5-6, E 5-7, E 5-9, E 5-10, E 5-12



	Merchandising Transactions	Merchandising Entries	Dr.	Cr.
Purchases	Purchasing merchandise for resale.	Merchandise Inventory	#	
		Cash or Accounts Payable		#
	Paying freight costs on purchases; FOB shipping point.	Merchandise Inventory	#	
		Cash		#
	Paying within discount period.	Accounts Payable	#	
		Merchandise Inventory		#
		Cash		#
	Paying outside discount period.	Accounts Payable	#	
		Cash		#
	Recording purchases returns or allowances.	Cash or Accounts Payable	#	
		Merchandise Inventory		#
Sales	Selling merchandise.	Cash or Accounts Receivable	#	
		Sales		#
		Cost of Goods Sold	#	
		Merchandise Inventory		#
	Receiving payment within discount period.	Cash	#	
		Sales Discounts	#	
		Accounts Receivable		#
	Receiving payment outside discount period.	Cash	#	
		Accounts Receivable		#
	Receiving sales returns of nondefective inventory.	Sales Returns and Allowances	#	
		Cash or Accounts Receivable		#
		Merchandise Inventory	#	
		Cost of Goods Sold		#
	Granting sales allowances.	Sales Returns and Allowances	#	
		Cash or Accounts Receivable		#
	Paying freight costs on sales; FOB destination.	Delivery Expense	#	
		Cash		#

	Merchandising Events	Adjusting and Closing Entries	Dr.	Cr.
Adjusting	Adjustment for shrinkage (occurs when recorded amount larger than physical inventory).	Cost of Goods Sold	#	
		Merchandise Inventory		#
Closing	Closing temporary accounts with credit balances.	Sales	#	
		Income Summary		#
	Closing temporary accounts with debit balances.	Income Summary	#	
		Sales Returns and Allowances		#
		Sales Discounts		#
		Cost of Goods Sold		#
		Delivery Expense		#
		"Other Expenses"		#
	No change to closing Income Summary and Withdrawals.			

Page 178 MORE ON FINANCIAL STATEMENT FORMATS P4 Define and prepare multiple-step and single-step income statements. This section covers two income statement formats: multiple-step and single-step. The classified balance sheet of a merchandiser also is covered. Multiple-Step Income Statement A multiple-step income statement details net sales and expenses and reports subtotals for various types of items. Exhibit 5.13 shows a multiple-step income statement. The statement has three main parts: (1) gross profit, which is net sales minus cost of goods sold; (2) income from operations, which is gross profit minus operating expenses; and (3) net income, which is income from operations plus or minus nonoperating items. EXHIBIT 5.13 Multiple-Step Income Statement *Cost of goods sold: Beginning inventory $ 19,000 Net cost of purchases 232,400 Goods available for sale 251,400 Less ending inventory 21,000 Cost of goods sold $230,400 Operating expenses are separated into two sections. Selling expenses are costs to market and distribute products and services such as advertising of merchandise, store supplies and rent, and delivery of goods to customers. General and administrative expenses are costs to administer a company's overall operations such as office salaries, office equipment, and office supplies. Expenses are allocated between these two sections when they contribute to more than one. Z-Mart allocates rent expense of $9,000 from its store building between two sections: $8,100 to selling expense and $900 to general and administrative expenses. Page 179 Nonoperating activities consist of other expenses, revenues, losses, and gains that are unrelated to a company's operations. Other revenues and gains commonly include interest revenue, dividend revenue, rent revenue, and gains from asset disposals. Other expenses and losses commonly include interest expense, losses from asset disposals, and casualty losses. When there are no reportable nonoperating activities, its income from

operations is simply labeled net income. Single-Step Income Statement A single-step income statement is shown in Exhibit 5.14. It lists cost of goods sold as another expense and shows only one subtotal for total expenses. Expenses are grouped into categories. Many companies use formats that combine features of both single- and multiple-step statements. Net income is the same under either format, so management chooses the format that best informs users. EXHIBIT 5.14 Single-Step Income Statement Table Summary: Table lists accounts and amounts. Column 1 lists the account names. Column 2 has the following blank rows: 1 through 6, 11 and 12. Column 3 has the following blank rows: 1 and 6 through 10. Z-MART Income Statement For Year Ended December 31, 2021 Revenues Net sales $314,700 Interest revenue 1,000 Gain on sale of building 2,500 Total revenues 318,200 Expenses Cost of goods sold $230,400 Selling expenses 42,100 General and administrative expenses 29,300 Interest expense 1,500 Total expenses 303,300 Net income $ 14,900 Classified Balance Sheet The classified balance sheet reports merchandise inventory as a current asset, usually after accounts receivable, according to how quickly they can be converted to cash. Inventory is converted less quickly to cash than accounts receivable because inventory first must be sold before cash can be received. Exhibit 5.15 shows the current asset section of Z-Mart's classified balance sheet (other sections are similar to the previous chapter). EXHIBIT 5.15 Classified Balance Sheet (partial) of a Merchandiser Z-MART Balance Sheet (partial) December 31, 2021 Current assets Cash $ 8,200 Accounts receivable 11,200 Merchandise inventory 21,000 Office supplies 550 Store supplies 250 Prepaid insurance 300 Total current assets $ 41,500 Point: Statement of owner's equity is the same for merchandisers and service companies. Page 180 NEED-TO-KNOW 5-5 Multiple- and Single-Step Income Statements P4 Taret's adjusted account balances from its general ledger on April 30, its fiscal year-end, are shown here in random order. (a) Prepare a multiple-step income statement that begins with gross sales and includes separate categories for net sales, cost of goods sold, selling expenses, and general and administrative expenses. (b) Prepare a single-step income statement that begins with net sales and includes these expense categories: cost of goods sold, selling expenses, and general and administrative expenses. Table Summary: Table lists accounts and amounts. Column 1 lists the account names. Column 2 has the following blank rows: 3, 4, and 6. Column 3 has the following blank rows: 1, 2, 5, and 7 through 16. Adjusted Account Balances Debit Credit Merchandise inventory $ 800 Other (noninventory) assets 2,600 Total liabilities $ 500 Taret, Capital 2,100 Taret, Withdrawals 300 Sales 9,500 Sales discounts 260 Sales returns and allowances 240 Cost of goods sold 6,500 Sales salaries expense 450 Rent expense—Selling space 400 Store supplies expense 30 Advertising expense 20 Office salaries expense 420 Rent expense—Office space 72 Office supplies expense 8 Totals $12,100 $12,100 Solution Multiple-step income statement. Table Summary: Table lists accounts and amounts. Column 1 lists the

account names. Column 2 has the following blank rows: 1, 2, 6 and 7. Column 3 has the following blank rows: 2 through 5. TARET Income Statement For Year Ended April 30 Sales $9,500 Less: Sales discounts $260 Sales returns and allowances 240 500 Net sales 9,000 Cost of goods sold 6,500 Gross profit 2,500 Operating expenses Selling expenses Sales salaries expense 450 Rent expense—Selling space 400 Store supplies expense 30 Advertising expense 20 Total selling expenses 900 General and administrative expenses Office salaries expense 420 Rent expense—Office space 72 Office supplies expense 8 Total general and administrative expenses 500 Total operating expenses 1,400 Net income $1,100 Single-step income statement. TARET Income Statement For Year Ended April 30 Net sales $9,000 Expenses Cost of goods sold $6,500 Selling expenses 900 General and administrative expenses 500 Total expenses 7,900 Net income $1,100 Do More: QS 5-16 though QS 5-21, E 5-17, E 5-18, E 5-19

Z-MART
Income Statement
For Year Ended December 31, 2021

Sales		$321,000
Less: Sales discounts	$ 4,300	
Sales returns and allowances	2,000	6,300
Net sales		314,700
Cost of goods sold*		230,400
Gross profit		84,300
Operating expenses		
Selling expenses		
Depreciation expense—Store equipment	3,000	
Sales salaries expense	18,500	
Rent expense—Selling space	8,100	
Store supplies expense	1,200	
Advertising expense	11,300	
Total selling expenses		42,100
General and administrative expenses		
Depreciation expense—Office equipment	700	
Office salaries expense	25,300	
Insurance expense	600	
Rent expense—Office space	900	
Office supplies expense	1,800	
Total general and administrative expenses		29,300
Total operating expenses		71,400
Income from operations		12,900
Other revenues and gains (expenses and losses)		
Interest revenue	1,000	
Gain on sale of building	2,500	
Interest expense	(1,500)	
Total other revenues and gains (expenses and losses)		2,000
Net income		$ 14,900

Gross profit computation

Income from operations computation

Nonoperating activities computation

Decision Analysis Acid-Test and Gross Margin Ratios A1 Compute and analyze the acid-test ratio and gross margin ratio. Acid-Test Ratio One measure of a merchandiser's ability to pay its current liabilities (referred to as its liquidity) is the acid-test ratio. The acid-test ratio, also called quick ratio, is defined as quick assets (cash, short-term investments, and current receivables) divided by current liabilities—see Exhibit 5.16. It differs from the current ratio by excluding less liquid current assets such as inventory and prepaid

expenses that take longer to be converted to cash. EXHIBIT 5.16 Acid-Test (Quick) Ratio Page 181 lzf/Shutterstock Exhibit 5.17 shows both the acid-test and current ratios of Nike and Under Armour for three recent years. Nike's acid-test ratio implies that it has enough quick assets to cover current liabilities. It is also on par with its competitor, Under Armour. Nike's current ratio suggests it has more than enough current assets to cover current liabilities. Analysts might argue that Nike could invest some current assets in more productive assets. An acid-test ratio less than 1.0 means that current liabilities exceed quick assets. A rule of thumb is that the acid-test ratio should have a value near, or higher than, 1.0. Less than 1.0 raises liquidity concerns unless a company can get enough cash from sales or if liabilities are not due until late in the next period. EXHIBIT 5.17 Acid-Test and Current Ratios for Two Competitors Table Summary: Company data are provided. Company names appear in first column and span several rows. The acid-test and current ratio rows for Nike are highlighted in red print. Company $ millions Current Year 1 Year Ago 2 Years Ago Nike Total quick assets $ 8,935 $ 8,743 $ 9,856 Total current assets $16,525 $15,134 $16,061 Total current liabilities $ 7,866 $ 6,040 $ 5,474 Acid-test ratio 1.1 1.4 1.8 Current ratio 2.1 2.5 2.9 Under Armour Acid-test ratio 1.1 0.9 0.9 Current ratio 1.9 2.0 2.2 Decision Maker Supplier A retailer requests to purchase supplies on credit from your company. You have no prior experience with this retailer. The retailer's current ratio is 2.1, its acid-test ratio is 0.5, and inventory makes up most of its current assets. Do you extend credit? ■ Answer Gross Margin Ratio Without enough gross profit, a merchandiser can fail. The gross margin ratio helps understand this link. It differs from the profit margin ratio in that it excludes all costs except cost of goods sold. The gross margin ratio (or gross profit ratio) is defined as gross margin (net sales minus cost of goods sold) divided by net sales—see Exhibit 5.18. EXHIBIT 5.18 Gross Margin Ratio Exhibit 5.19 shows the gross margin ratio of Nike for three recent years. For Nike, each $1 of sales in the current year yielded about 44.7¢ in gross margin to cover all expenses and still produce a net income. This 44.7¢ margin is up from 43.8¢ in the prior year. This increase is favorable. EXHIBIT 5.19 Nike's Gross Margin Ratio $ millions Current Year 1 Year Ago 2 Years Ago Gross margin $17,474 $15,956 $15,312 Net sales $39,117 $36,397 $34,350 Gross margin ratio 44.7% 43.8% 44.6% Decision Maker Financial Officer Your company has a 36% gross margin ratio and a 17% net profit margin ratio. Industry averages are 44% for gross margin and 16% for net profit margin. Do these comparative results concern you? ■ Answer

Page 182 NEED-TO-KNOW 5-6 COMPREHENSIVE 1 Single- and Multiple-Step Income Statements, Closing Entries, and Analysis Using Acid-Test and Gross Margin Ratios Use the following adjusted trial balance and additional information to complete the requirements.

Table Summary: Table lists accounts and amounts. Column 1 lists the account names. Column 2 has the following blank rows: 6 through 9, and 11. Column 3 has the following blank rows: 1 through 5, 10, and 12 through 23. KC ANTIQUES Adjusted Trial Balance December 31 Debit Credit Cash $ 7,000 Accounts receivable 13,000 Merchandise inventory (ending) 60,000 Store supplies 1,500 Equipment 45,600 Accumulated depreciation—Equipment $ 16,600 Accounts payable 9,000 Salaries payable 2,000 K. Carter, Capital 79,000 K. Carter, Withdrawals 10,000 Sales 343,250 Sales discounts 5,000 Sales returns and allowances 6,000 Cost of goods sold 159,900 Depreciation expense—Store equipment 4,100 Depreciation expense—Office equipment 1,600 Sales salaries expense 30,000 Office salaries expense 34,000 Insurance expense 11,000 Rent expense—Selling space 16,800 Rent expense—Office space 7,200 Store supplies expense 5,750 Advertising expense 31,400 Totals $449,850 $449,850 Supplementary records for the year reveal the following itemized costs for merchandising activities. Invoice cost of merchandise purchases $150,000 Purchases discounts received 2,500 Purchases returns and allowances 2,700 Cost of transportation-in 5,000 Required Use the supplementary records to compute the total cost of merchandise purchases for the year. Prepare a multiple-step income statement for the year. (Beginning inventory was $70,100.) Prepare a single-step income statement for the year. Prepare closing entries for KC Antiques at December 31. Compute the acid-test ratio and the gross margin ratio. Explain the meaning of each ratio and interpret them for KC Antiques. SOLUTION Invoice cost of merchandise purchases $150,000 Less: Purchases discounts received (2,500) Purchases returns and allowances (2,700) Add: Cost of transportation-in 5,000 Total cost of merchandise purchases $149,800Page 183 Multiple-step income statement. Table Summary: Table lists accounts and amounts. Column 1 lists the account names. Column 2 has the following blank rows: 1, 4 through 8, 15, 21, and 22. Column 3 has the following blank rows: 2 and 7 through 20. Note: Tax expense for a corporation appears immediately before Net Income in its own category. KC ANTIQUES Income Statement For Year Ended December 31 Sales $343,250 Less: Sales discounts $ 5,000 Sales returns and allowances 6,000 11,000 Net sales 332,250 Cost of goods sold 159,900 Gross profit 172,350 Expenses Selling expenses Depreciation expense—Store equipment 4,100 Sales salaries expense 30,000 Rent expense—Selling space 16,800 Store supplies expense 5,750 Advertising expense 31,400 Total selling expenses 88,050 General and administrative expenses Depreciation expense—Office equipment 1,600 Office salaries expense 34,000 Insurance expense 11,000 Rent expense—Office space 7,200 Total general and administrative expenses 53,800 Total operating expenses 141,850 Net income $ 30,500 Single-step income statement. Table Summary: Table lists accounts and amounts. Column 1 lists the account names. Column 2 has the following blank rows: 1, 2, 6 and 7. Column 3 has the following blank rows: 2 through 5. KC ANTIQUES Income

Statement For Year Ended December 31 Net sales $332,250 Expenses Cost of goods sold $159,900 Selling expenses 88,050 General and administrative expenses 53,800 Total expenses 301,750 Net income $ 30,500 Table Summary: Journal entries with date, account name, and debit amount on initial line; indented account name and credit amount on following line; and description on the final line of entry. Second entry has 11 accounts credited. Dec. 31 Sales 343,250 Income Summary 343,250 Close credit balances in temporary accounts. Dec. 31 Income Summary 312,750 Sales Discounts 5,000 Sales Returns and Allowances 6,000 Cost of Goods Sold 159,900 Depreciation Expense—Store Equipment 4,100 Depreciation Expense—Office Equipment 1,600 Sales Salaries Expense 30,000 Office Salaries Expense 34,000 Insurance Expense 11,000 Rent Expense—Selling Space 16,800 Rent Expense—Office Space 7,200 Store Supplies Expense 5,750 Advertising Expense 31,400 Close debit balances in temporary accounts. Dec. 31 Income Summary 30,500 K. Carter, Capital 30,500 Close Income Summary account. Dec. 31 K. Carter, Capital 10,000 K. Carter, Withdrawals 10,000 Close Withdrawals account. Gross margin ratio = Gross profit/Net sales = $172,350/$332,250 = 0.52 (or 52%) KC Antiques has a healthy acid-test ratio of 1.82. This means it has $1.82 in liquid assets to satisfy each $1.00 in current liabilities. The gross margin of 0.52 shows that KC Antiques spends 48¢ ($1.00 − $0.52) of every dollar of net sales on the costs of acquiring the merchandise it sells. This leaves 52¢ of every dollar of net sales to cover other expenses incurred in the business and to provide a net profit.

Page 184 NEED-TO-KNOW 5-7 COMPREHENSIVE 2 Recording Merchandising Transactions—Both Seller and Buyer Prepare journal entries for the following transactions for both the seller (BMX) and buyer (Sanuk). May 4 BMX sold $1,500 of merchandise on account to Sanuk, terms FOB shipping point, n/45, invoice dated May 4. The cost of the merchandise was $900. 6 Sanuk paid transportation charges of $30 on the May 4 purchase from BMX. 8 BMX sold $1,000 of merchandise on account to Sanuk, terms FOB destination, n/15, invoice dated May 8. The cost of the merchandise was $700. This sale permitted returns for 30 days. 10 BMX paid transportation costs of $50 for delivery of merchandise sold to Sanuk on May 8. 16 Sanuk returned $200 of merchandise purchased on May 8 for full credit. The merchandise, which had cost $140, is returned to inventory. 18 BMX received payment from Sanuk for the May 8 purchase. 21 BMX sold $2,400 of merchandise on account to Sanuk, terms FOB shipping point, 2/10, n/60. The cost of the merchandise was $1,440. This sale permitted returns for 90 days. 31 BMX received payment from Sanuk for the May 21 purchase, less discount. Solution Table Summary: (Left)Journal entries with date, account name, and debit amount on initial line; indented account name and credit amount on following line. May 4 has two journal entries, as do

May 8, May 16, and May 21. Entry for May 31 has two accounts debited./(Right)Journal entries with account name and debit amount on initial line; indented account name and credit amount on following line. Final entry has two accounts credited. BMX (Seller) Sanuk (Buyer) May 4 Accounts Receivable—Sanuk 1,500 Sales 1,500 Cost of Goods Sold 900 Merchandise Inventory 900 6 No entry. 8 Accounts Receivable—Sanuk 1,000 Sales 1,000 Cost of Goods Sold 700 Merchandise Inventory 700 10 Delivery Expense 50 Cash 50 16 Sales Returns & Allowances 200 Accounts Receivable—Sanuk 200 Merchandise Inventory 140 Cost of Goods Sold 140 18 Cash 800 Accounts Receivable—Sanuk 800 21 Accounts Receivable—Sanuk 2,400 Sales 2,400 Cost of Goods Sold 1,440 Merchandise Inventory 1,440 31 Cash 2,352 Sales Discounts 48 Accounts Receivable—Sanuk 2,400 Merchandise Inventory 1,500 Accounts Payable—BMX 1,500 Merchandise Inventory 30 Cash 30 Merchandise Inventory 1,000 Accounts Payable—BMX 1,000 No entry. Accounts Payable—BMX 200 Merchandise Inventory 200 Accounts Payable—BMX 800 Cash 800 Merchandise Inventory 2,400 Accounts Payable—BMX 2,400 Accounts Payable—BMX 2,400 Merchandise Inventory 48 Cash 2,352

APPENDIX 5A: Periodic Inventory System P5 Record and compare merchandising transactions using both periodic and perpetual inventory systems. A periodic inventory system requires updating the inventory account only at the end of a period. During the period, the Merchandise Inventory balance remains unchanged and cost of merchandise is recorded in a temporary Purchases account. When a company sells merchandise, it records revenue but not the cost of the goods sold. At the end of the period, it takes a physical count of inventory to get ending inventory. The cost of goods sold is then computed as cost of merchandise available for sale minus ending inventory. Page 185 Recording Merchandise Purchases Under a periodic system, the purchases, purchases returns and allowances, purchases discounts, and transportation-in transactions are recorded in separate temporary accounts. At period-end, each of these temporary accounts is closed, which updates the Merchandise Inventory account. To demonstrate, journal entries under the periodic inventory system are shown for the most common transactions (codes a through d link these transactions to those in the chapter). For comparison, perpetual system journal entries are shown to the right of each periodic entry. Differences are highlighted. Credit Purchases with Cash Discounts The periodic system uses a temporary Purchases account that accumulates the cost of all purchase transactions during each period. The Purchases account has a normal debit balance, as it increases the cost of merchandise available for sale. Z-Mart's November 2 entry to record the purchase of merchandise for $500 on credit with terms of 2/10, n/30 is Table Summary: (Left) Journal entry with account name (highlighted) and debit amount on initial line, and

indented account name and credit amount on following line. Heading above entry journal entry appears in red print./(Right) Journal entry with account name (highlighted) and debit amount on initial line, and indented account name and credit amount on following line. (a) Periodic Perpetual Purchases 500 Accounts Payable 500 Merchandise Inventory 500 Accounts Payable 500 Payment of Purchases The periodic system uses a temporary Purchases Discounts account that accumulates discounts taken during the period. If payment for transaction a is made within the discount period, the entry is Table Summary: (L)Journal entry with account name and debit amount on initial line, and first indented account name (highlighted) and credit amount on following line, with another account name and credit amount below. Heading above entry journal entry appears in red print./ (R)Journal entry with account name and debit amount on initial line, and first indented account name (highlighted) and credit amount on following line, with another account name and credit amount below. (b1) Periodic Perpetual Accounts Payable 500 Purchases Discounts* 10 Cash 490 *$500 × 2% Accounts Payable 500 Merchandise Inventory* 10 Cash 490 *$500 × 2% If payment for transaction a is made after the discount period expires, the entry is Table Summary: (L) Journal entry with account name and debit amount on initial line, and indented account name and credit amount on following line. Heading above entry journal entry appears in red print./ (R)Journal entry with account name and debit amount on initial line, and indented account name and credit amount on following line. (b2) Periodic Perpetual Accounts Payable 500 Cash 500 Accounts Payable 500 Cash 500 Purchases Allowances The buyer and seller agree to a $30 purchases allowance for defective goods (whether paid within the discount period or not). In the periodic system, the temporary Purchases Returns and Allowances account accumulates the cost of all returns and allowances during a period. The buyer records the $30 allowance as Table Summary: (L)Journal entry with account name and debit amount on initial line, and indented account name (highlighted) and credit amount on following line. Heading above entry journal entry appears in red print. / (R)Journal entry with account name and debit amount on initial line, and indented account name (highlighted) and credit amount on following line. (c1) Periodic Perpetual Table Summary: (L) Journal entry with account name and debit amount on initial line, and indented account name (highlighted) and credit amount on following line. Heading above entry journal entry appears in red print./ (R)Journal entry with account name and debit amount on initial line, and indented account name (highlighted) and credit amount on following line. Accounts Payable 30 Purchases Returns and Allowances 30 Accounts Payable 30 Merchandise Inventory 30 Point: Purchases Discounts and Purchases Returns and Allowances are contra purchases accounts and have normal credit balances, as they both decrease the cost of merchandise available for sale. Purchases Returns The buyer returns $50 of merchandise within the discount period. The entry is Table Summary: (L)Journal entry with account name

(highlighted) and debit amount on initial line, and indented account name and credit amount on following line. Heading above entry journal entry appears in red print. / (R)Journal entry with account name (highlighted) and debit amount on initial line, and indented account name and credit amount on following line. (c2) Periodic Perpetual Accounts Payable 50 Purchases Returns and Allowances 50 Accounts Payable 50 Merchandise Inventory 50 Transportation-In The buyer paid a $75 freight charge to transport goods with terms FOB shipping point. In the periodic system, this cost is recorded in a temporary Transportation-In account, which has a normal debit balance as it increases the cost of merchandise available for sale. Table Summary: (L)Journal entry with account name and debit amount on initial line, and indented account name and credit amount on following line. Below is indented heading (highlighted) with no accompanying amount. Heading above entry journal entry appears in red print. / (R)Journal entry with account name and debit amount on initial line, and indented account name and credit amount on following line. A second journal entry appears with both debit and credit account names and amounts highlighted. (d) Periodic Perpetual Transportation-In 75 Cash 75 Merchandise Inventory 75 Cash 75Page 186 Recording Merchandise Sales Journal entries under the periodic system are shown for the most common transactions (codes e through h link these transactions to those in the chapter). Perpetual system entries are shown to the right of each periodic entry. Differences are highlighted. Credit Sales and Receipt of Payments Both the periodic and perpetual systems record sales entries similarly, using the gross method. The same holds for entries related to payment of receivables from sales both during and after the discount period. However, under the periodic system, the cost of goods sold is not recorded at the time of each sale (whereas it is under the perpetual system). The entry to record $1,000 in credit sales (costing $300) is Table Summary: (L)Journal entry with account name and debit amount on initial line, and indented account name and credit amount on following line. Below is indented heading (highlighted) with no accompanying amount. Heading above entry journal entry appears in red print. / (R)Journal entry with account name and debit amount on initial line, and indented account name and credit amount on following line. A second journal entry appears with both debit and credit account names and amounts highlighted. Periodic Perpetual Accounts Receivable 1,000 Sales 1,000 No cost-side entry Accounts Receivable 1,000 Sales 1,000 Cost of Goods Sold 300 Merchandise Inventory 300 Returns Received by Seller A customer returned merchandise for a cash refund. The goods sell for $15 and cost $9. (Recall: The periodic system records only the revenue effect, not the cost effect, for sales transactions.) The entry for the seller to take back the return is Table Summary: (L)Journal entry with account name and debit amount on initial line, and indented account name and credit amount on following line. Below is indented heading (highlighted) with no accompanying amount. Heading above entry journal entry appears in red print. / (R)Journal

entry with account name and debit amount on initial line, and indented account name and credit amount on following line. A second journal entry appears with both debit and credit account names and amounts highlighted. Periodic Perpetual (e1) (e2) Sales Returns and Allowances 15 Cash 15 No entry Sales Returns and Allowances 15 Cash 15 Merchandise Inventory 9 Cost of Goods Sold 9 Allowances Granted by Seller The seller gives a price reduction and credits the buyer's accounts receivable for $10. The entry is identical under the periodic and perpetual systems. The seller records this allowance as Table Summary: (L) Journal entry with account name and debit amount on initial line, and indented account name and credit amount on following line. Heading above entry journal entry appears in red print./ (R)Journal entry with account name and debit amount on initial line, and indented account name and credit amount on following line. Periodic Perpetual (f) Sales Returns and Allowances 10 Accounts Receivable 10 Sales Returns and Allowances 10 Accounts Receivable 10 Recording Adjusting Entries Shrinkage—Adjusting Entry Adjusting entries for the two systems are in Exhibit 5A.1. The $250 shrinkage is only recorded under the perpetual system—see entry z in Exhibit 5A.1. Shrinkage in cost of goods is unknown using a periodic system because inventory is not continually updated and therefore cannot be compared to the physical count. EXHIBIT 5A.1 Comparison of Adjusting Entries—Periodic and Perpetual Periodic—Adjusting Entries Perpetual—Adjusting Entries (z)(g) (h1) (h2) Table Summary: Side-by-side journal entries made under Periodic (heading in red print) and Perpetual systems. Under Periodic, the credit account name in the final entry is highlighted. Under Perpetual, the debit and credit account names and amounts for the first entry as well as the credit account name of the final entry are highlighted. All entries are shaded in gray. None Sales Discounts 50 Allowance for Sales Discounts 50 Sales Returns and Allowances 900 Sales Refund Payable 900 Inventory Returns Estimated 300 Purchases 300 Cost of Goods Sold 250 Merchandise Inventory 250 Sales Discounts 50 Allowance for Sales Discounts 50 Sales Returns and Allowances 900 Sales Refund Payable 900 Inventory Returns Estimated 300 Cost of Goods Sold 300 Entries in gray are covered in Appendix 5B. Entries in gray are covered in Appendix 5B.Page 187 Expected Sales Discounts—Adjusting Entry Both the periodic and perpetual methods make a period-end adjusting entry under the gross method to estimate the $50 sales discounts arising from current-period sales that are likely to be taken in future periods. Z-Mart made the period-end adjusting entry g in Exhibit 5A.1 for expected sales discounts. Expected Returns and Allowances—Adjusting Entry Both the periodic and perpetual inventory systems estimate returns and allowances arising from current-period sales that will occur in future periods. The adjusting entry for both systems is identical for the sales side, but slightly different for the cost side. The period-end entries h1 and h2 in Exhibit 5A.1 are used to record the updates to expected sales refunds of $900 and the cost side of $300. Under both systems, the seller sets up a Sales Refund Payable account, which is a current liability

reflecting the amount expected to be refunded to customers, and an Inventory Returns Estimated account, which is a current asset reflecting the inventory estimated to be returned. Recording Closing Entries Periodic and perpetual inventory systems have slight differences in closing entries. The period-end Merchandise Inventory balance (unadjusted) is $19,000 under the periodic system. Because the periodic system does not update the Merchandise Inventory balance during the period, the $19,000 amount is the beginning inventory. A physical count of inventory taken at the end of the period reveals $21,000 of merchandise available. Closing entries for the two systems follow. Recording the periodic inventory balance is a two-step process. The ending inventory balance of $21,000 is entered by debiting the inventory account in the first closing entry. The beginning inventory balance of $19,000 is deleted by crediting the inventory account in the second closing entry.1 Table Summary: (Left) Journal entries: first entry with four accounts and amounts debited (second, third, and fourth accounts/amounts in red print); indented account name and amount credited on following line, with amount highlighted. Second entry with account and amount debited (highlighted); indent accounts and amounts credited on next 11 lines (third, fourth, and fifth accounts/amounts in red print). Third and fourth journal entries with account and amount debited on first line; indented account and amount credited on next line./(Right) Journal entries: first entry, account and amount debited on first line; indented account and amount (highlighted) credited on next line. In second entry, account and amount (highlighted) on first line; indented accounts and amounts credited on next nine lines (third credit in red print). Third and fourth journal entries with account and amount debited on first line; indented account and amount credited on next line. Periodic—Closing Entries Perpetual—Closing Entries (1) (2) (3) (4) Sales 321,000 Merchandise Inventory (ending) 21,000 Purchases Discounts 4,200 Purchases Returns and Allowances 1,500 Income Summary 347,700 Income Summary 334,800 Sales Discounts 4,300 Sales Returns and Allowances 2,000 Merch. Inven. (beginning) 19,000 Purchases 235,800 Transportation-In 2,300 Depreciation Expense 3,700 Salaries Expense 43,800 Insurance Expense 600 Rent Expense 9,000 Supplies Expense 3,000 Advertising Expense 11,300 Income Summary 12,900 K. Marty, Capital 12,900 K. Marty, Capital 4,000 K. Marty, Withdrawals 4,000 Sales 321,000 Income Summary 321,000 Income Summary 308,100 Sales Discounts 4,300 Sales Returns and Allowances 2,000 Cost of Goods Sold 230,400 Depreciation Expense 3,700 Salaries Expense 43,800 Insurance Expense 600 Rent Expense 9,000 Supplies Expense 3,000 Advertising Expense 11,300 Income Summary 12,900 K. Marty, Capital 12,900 K. Marty, Capital 4,000 K. Marty, Withdrawals 4,000Page 188 By updating Merchandise Inventory and closing Purchases, Purchases Discounts, Purchases Returns and Allowances, and Transportation-In, the periodic system transfers the cost of sales amount to Income Summary. Review the periodic side of the closing entries and see that the red items affect Income Summary as follows. Credit to Income Summary in the first

closing entry includes amounts from Merchandise inventory (ending) $ 21,000 Purchases discounts 4,200 Purchases returns and allowances 1,500 Debit to Income Summary in the second closing entry includes amounts from Merchandise inventory (beginning) (19,000) Purchases (235,800) Transportation-in (2,300) Net effect on Income Summary (net debit = cost of goods sold) $(230,400) This $230,400 effect on Income Summary is the cost of goods sold amount (which is equal to cost of goods sold reported in a perpetual inventory system). The periodic system transfers cost of goods sold to the Income Summary account but without using a Cost of Goods Sold account. Also, the periodic system does not separately measure shrinkage. Instead, it computes cost of goods available for sale, subtracts the cost of ending inventory, and defines the difference as cost of goods sold, which includes shrinkage. Preparing Financial Statements The financial statements of a merchandiser using the periodic system are similar to those for a service company described in prior chapters. The income statement mainly differs by the inclusion of cost of goods sold and gross profit—of course, net sales is affected by discounts, returns, and allowances. The cost of goods sold section under the periodic system is shown here. The balance sheet mainly differs by the inclusion of merchandise inventory, inventory returns estimated, allowance for sales discounts, and sales refund payable. Visit the Additional Student Resource section of the Connect eBook to view sample chart of accounts for periodic and perpetual systems. Calculation of Cost of Goods Sold Beginning inventory $ 19,000 Net cost of purchases 232,400 Cost of goods available for sale 251,400 Less ending inventory 21,000 Cost of goods sold $230,400

APPENDIX 5B: Adjusting Entries under New Revenue Recognition Rules P6 Prepare adjustments for discounts, returns, and allowances per revenue recognition rules. Expected Sales Discounts—Adjusting Entry New revenue recognition rules require sales to be reported at the amount expected to be received. This means that a period-end adjusting entry is made to estimate sales discounts for current-period sales that are expected to be taken in future periods. To demonstrate, assume Z-Mart has the following unadjusted balances. Accounts Receivable $11,250 Allowance for Sales Discounts $0 Of the $11,250 of receivables, $2,500 of them are within the 2% discount period, for which we expect buyers to take $50 in future-period discounts (computed as $2,500 × 2%) arising from this period's sales. The adjusting entry for the $50 update to Allowance for Sales Discounts is Table Summary: Journal entry with date, account name, and debit amount on first line; indented account name and credit amount on next line; and description on the last line. (g) Dec. 31 Sales Discounts 50 Allowance for Sales Discounts 50 Adjustment for future discounts. Page 189 Allowance for Sales Discounts is a contra asset account and is reported on the balance sheet as a reduction to the Accounts Receivable asset

account. The Allowance for Sales Discounts account has a normal credit balance because it reduces Accounts Receivable, which has a normal debit balance. This adjusting entry results in both accounts receivable and sales being reported at expected amounts.* Allowance for Sales Discounts Beg. bal. 0 Req. adj. 50 Est. bal. 50 Balance Sheet—partial Accounts receivable $ 11,250 Less allowance for sales discounts 50 Accounts receivable, net $11,200 Income Statement—partial Sales $321,000 Less sales discounts, returns & allowances 6,300 Net sales $314,700 *Next Period Adjustment The Allowance for Sales Discounts balance remains unchanged during a period except for the period-end adjusting entry. At next period-end, assume that Z-Mart computes an $80 balance for the Allowance for Sales Discounts. Using our three-step adjusting process we get: Step 1: Current bal. is $50 credit in Allowance for Sales Discounts. Step 2: Current bal. should be $80 credit in Allowance for Sales Discounts. Step 3: Record entry to get from step 1 to step 2. Expected Returns and Allowances—Adjusting Entries To avoid overstatement of sales and cost of sales, sellers estimate sales returns and allowances in the period of the sale. Estimating returns and allowances requires companies to maintain the following two balance sheet accounts that are set up with adjusting entries. Two adjusting entries are made: one for the revenue side and one for the cost side. Current Asset⟶Inventory Returns Estimated Current Liability⟶Sales Refund Payable Revenue Side for Expected R&A When returns and allowances are expected, a seller sets up a Sales Refund Payable account, which is a current liability showing the amount expected to be refunded to customers. Assume that on December 31 the company estimates future sales refunds to be $1,200. Assume also that the unadjusted balance in Sales Refund Payable is a $300 credit. The adjusting entry for the $900 update to Sales Refund Payable follows. The Sales Refund Payable account is updated only during the adjusting entry process. Its balance remains unchanged during the period when actual returns and allowances are recorded. Table Summary: Journal entry with date, account name, and debit amount on first line; indented account name (in red print) and credit amount on next line; and description on the last line. (h1) Dec. 31 Sales Returns and Allowances 900 Sales Refund Payable 900 Expected refund of sales.* *This entry uses our three-step adjusting process: Step 1: Current bal. is $300 credit for Sales Refund Payable. Step 2: Current bal. should be $1,200 credit for Sales Refund Payable. Step 3: Record entry to get from step 1 to step 2. Sales Refund Payable Beg. bal. 300 Req. adj. 900 Est. bal. 1,200 Cost Side for Expected R&A On the cost side, some inventory is expected to be returned, which means that cost of goods sold recorded at the time of sale is overstated due to expected returns. A seller sets up an Inventory Returns Estimated account, which is a current asset showing the inventory estimated to be returned. Extending the example above, assume that the company estimates future inventory returns to be $500 (which is the cost side of the $1,200 expected

returns and allowances above). Assume also that the (beginning) unadjusted balance in Inventory Returns Estimated is a $200 debit. The adjusting entry for the $300 update to expected returns follows. The Inventory Returns Estimated account is updated only during the adjusting entry process. Its balance remains unchanged during the period when actual returns and allowances are recorded. If estimates of returns and allowances prove too high or too low, we adjust future estimates accordingly. Table Summary: Journal entry with date, and account name and debit amount (both in red print) on first line; indented account name and credit amount on next line; and description on the last line. (h2) Dec. 31 Inventory Returns Estimated 300 Cost of Goods Sold 300 Expected return of inventory.* *This entry uses our three-step adjusting process: Step 1: Current bal. is $200 debit for Inventory Returns Estimated. Step 2: Current bal. should be $500 debit for Inventory Returns Estimated. Step 3: Record entry to get from step 1 to step 2. Inventory Returns Estimated Beg. bal. 200 Req. adj. 300 Est. bal. 500 Page 190 NEED-TO-KNOW 5-8 Estimating Discounts, Returns, and Allowances P6 At the current year-end, a company shows the following unadjusted balances for selected accounts. Allowance for Sales Discounts $ 75 credit Sales Refund Payable 800 credit Inventory Returns Estimated 450 debit Sales Discounts 1,850 debit Sales Returns and Allowances 4,825 debit Cost of Goods Sold 9,875 debit After an analysis of future sales discounts, the company estimates that the Allowance for Sales Discounts account should have a $275 credit balance. Prepare the current year-end adjusting journal entry for future sales discounts. After an analysis of future sales returns and allowances, the company estimates that the Sales Refund Payable account should have an $870 credit balance (revenue side). After an analysis of future inventory returns, the company estimates that the Inventory Returns Estimated account should have a $500 debit balance (cost side). Solution Table Summary: Journal entries with date, account name, and debit amount on first line; indented account name and credit amount on following line; and description on the final line of entry. a. Dec. 31 Sales Discounts 200 Allowance for Sales Discounts 200 Adjustment for future discounts. $275 Cr. − $75 Cr. b. Dec. 31 Sales Returns and Allowances 70 Sales Refund Payable 70 Adjustment for future sales refund. $870 Cr. − $800 Cr. c. Dec. 31 Inventory Returns Estimated 50 Cost of Goods Sold 50 Adjustment for future inventory returns. $500 Dr. − $450 Dr. Do More: QS 5-28, QS 5-29, E 5-25, E 5-26, E 5-27

APPENDIX 5C: Net Method for Merchandising P7 Record and compare merchandising transactions using the gross method and net method. The net method records an invoice at its net amount (net of any cash discount). The gross method, covered earlier in the chapter, initially records an invoice at its gross (full) amount. This appendix records merchandising

transactions using the net method. Differences with the gross method are highlighted. When invoices are recorded at net amounts, any cash discounts are deducted from the balance of the Merchandise Inventory account when initially recorded. This assumes that all cash discounts will be taken. If any discounts are later lost, they are recorded in a Discounts Lost expense account reported on the income statement. Perpetual Inventory System PURCHASES—Perpetual A company purchases merchandise on November 2 at a $500 invoice price ($490 net) with terms of 2/10, n/30. Its November 2 entries under the gross and net methods are Table Summary: Journal entries in two columns. Debit and credit amounts on both sides are highlighted. Gross Method—Perpetual Net Method—Perpetual Merchandise Inventory 500 Accounts Payable 500 Merchandise Inventory 490 Accounts Payable 490 If the invoice is paid on (or before) November 12 within the discount period, it records Table Summary: Journal entries in two columns. Debit amount and credit account and amount on left side are highlighted. Debit amount on right side is highlighted. Gross Method—Perpetual Net Method—Perpetual Accounts Payable 500 Merchandise Inventory 10 Cash 490 Accounts Payable 490 Cash 490Page 191 If the invoice is paid after the discount period, it records Table Summary: Journal entries in two columns. Debit amount on left side is highlighted. Debit amount of first debit entry and name and debit amount of second line on right side are highlighted. Gross Method—Perpetual Net Method—Perpetual Accounts Payable 500 Cash 500 Accounts Payable 490 Discounts Lost* 10 Cash 500 *For simplicity, we record Discounts Lost on the payment date. SALES—Perpetual A company sells merchandise on November 2 at a $500 invoice price ($490 net) with terms of 2/10, n/30. The goods cost $200. Its November 2 entries are Table Summary: Journal entries in two columns. Debit and credit amounts of first entry on left and first entry on right are highlighted. D Gross Method—Perpetual Net Method—Perpetual Accounts Receivable 500 Sales 500 Accounts Receivable 490 Sales 490 Cost of Goods Sold 200 Merchandise Inventory 200 Cost of Goods Sold 200 Merchandise Inventory 200 If cash is received on (or before) November 12 within the discount period, it records Table Summary: Journal entries in two columns. Second debit amount and name and credit amount on left side are highlighted. Credit amount on both sides is highlighted. Gross Method—Perpetual Net Method—Perpetual Cash 490 Sales Discounts 10 Accounts Receivable 500 Cash 490 Accounts Receivable 490 If cash is received after the discount period, it records Table Summary: Journal entries in two columns. Credit amount on left side is highlighted. First credit account name and amount and credit amount on line below on right side are highlighted. Gross Method—Perpetual Net Method—Perpetual Cash 500 Accounts Receivable 500 Cash 500 Interest Revenue 10 Accounts Receivable 490

APPENDIX 5D: Work Sheet—Perpetual System Exhibit 5D.1 shows the work sheet for preparing financial statements of a merchandiser. It differs slightly from the work sheet layout in the prior chapter—the differences are in orange boldface. The adjustments in the work sheet reflect the following: (1) expiration of $600 of prepaid insurance, (2) use of $3,000 of supplies, (3) depreciation of $3,700 for equipment, (4) accrual of $800 of unpaid salaries, and (5) inventory shrinkage of $250. Once the adjusted amounts are extended into the financial statement columns, the information is used to develop financial statements. EXHIBIT 5D.1 Work Sheet for Merchandiser (using a perpetual system) PROBLEM SET A Problem 5-6AD ONLINE APPENDIX: Preparing a work sheet for a merchandiser P3 Refer to the data and information in Problem 5-5A. Required Prepare and complete the entire 10-column work sheet for Nelson Company. Follow the structure of Exhibit 5D.1. PROBLEM SET B Problem 5-6BD ONLINE APPENDIX: Preparing a work sheet for a merchandiser P3 Refer to the data and information in Problem 5-5B. Required Prepare and complete the entire 10-column work sheet for Foster Products Company. Follow the structure of Exhibit 5D.1.

	A	B	C	D	E	F	G	H	I	J	K	L
1			Unadjusted Trial Balance		Adjustments		Adjusted Trial Balance		Income Statement		Balance Sheet and Statement of Equity	
2	No.	Account	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
3	101	Cash	8,200				8,200				8,200	
4	106	Accounts receivable	11,250				11,250				11,250	
5	108	Allowance for sales discounts		0		(g) 50		50				50
6	**119**	**Merchandise inventory**	**21,250**			**(5) 250**	**21,000**				**21,000**	
7	121	Inventory returns estimated	200		(h2) 300		500				500	
8	126	Supplies	3,800			(2) 3,000	800				800	
9	128	Prepaid insurance	900			(1) 600	300				300	
10	167	Equipment	34,200				34,200				34,200	
11	168	Accumulated depr.—Equip.		3,700		(3) 3,700		7,400				7,400
12	201	Accounts payable		16,000				16,000				16,000
13	209	Salaries payable				(4) 800		800				800
14	227	Sales refund payable		300		(h1) 900		1,200				1,200
15	301	K. Marty, Capital		41,900				41,900				41,900
16	302	K. Marty, Withdrawals	4,000				4,000				4,000	
17	**413**	**Sales**		**321,000**				**321,000**		**321,000**		
18	**414**	**Sales returns and allowances**	**1,100**		**(h1) 900**		**2,000**		**2,000**			
19	**415**	**Sales discounts**	**4,250**		**(g) 50**		**4,300**		**4,300**			
20	**502**	**Cost of goods sold**	**230,450**		**(5) 250**	**(h2) 300**	**230,400**		**230,400**			
21	612	Depreciation expense—Equip.			(3) 3,700		3,700		3,700			
22	622	Salaries expense	43,000		(4) 800		43,800		43,800			
23	637	Insurance expense			(1) 600		600		600			
24	640	Rent expense	9,000				9,000		9,000			
25	652	Supplies expense			(2) 3,000		3,000		3,000			
26	655	Advertising expense	11,300				11,300		11,300			
27		Totals	382,900	382,900	9,600	9,600	388,350	388,350	308,100	321,000	80,250	67,350
28		Net income							12,900			12,900
29		Totals							321,000	321,000	80,250	80,250
30												

Summary: Cheat Sheet MERCHANDISING ACTIVITIES Merchandise: Goods a company buys to resell. Cost of goods sold: Costs of merchandise sold. Gross profit (gross margin):

Net sales minus cost of goods sold. Computing net income (service company vs. merchandiser): Service Company Merchandiser Inventory: Costs of merchandise owned but not yet sold. It is a current asset on the balance sheet. Merchandise Cost Flows: Perpetual inventory system: Updates accounting records for each purchase and each sale of inventory. Periodic inventory system: Updates accounting records for purchases and sales of inventory only at the end of a period. MERCHANDISING PURCHASES Cash discount: A purchases discount on the price paid by the buyer, or a sales discount on the amount received for the seller. Credit terms example: “2/10, n/60” means full payment is due within 60 days, but the buyer can deduct 2% of the invoice amount if payment is made within 10 days. Gross method: Initially record purchases at gross (full) invoice amounts. Purchasing Merchandise for Resale Entries: Table Summary: First column contains description of transaction that takes two to three lines. Journal entries with account name and debit amount on initial line, and indented account name and credit amount on following line or lines of entry. Second journal entry has two accounts credited. Purchasing merchandise on credit Merchandise Inventory 500 Accounts Payable 500 Table Summary: First column contains description of transaction that takes two to three lines. Journal entries with account name and debit amount on initial line, and indented account name and credit amount on following line or lines of entry. Second journal entry has two accounts credited. Paying within discount period Accounts Payable 500 (Inventory reduced by Merchandise Inventory 10 discount taken) Cash 490 Paying outside discount period Accounts Payable 500 Cash 500 Recording purchases returns or allowances Cash or Accounts Payable 30 Merchandise Inventory 30 Transportation Costs and Ownership Transfer Rules: Table Summary: Fourth column contains two-line journal entry. Shipping Terms Ownership Transfers at Goods in Transit Owned by Transportation Costs Paid by FOB shipping point Shipping point Buyer Buyer Merchandise Inventory # Cash # FOB destination Destination Seller Seller Delivery Expense # Cash # Page 192 MERCHANDISING SALES Table Summary: First column contains description of transaction that takes two lines. Journal entries with account name and debit amount on initial line, and indented account name and credit amount on following line or lines of entry. Second journal entry has two accounts credited. Selling merchandise Accounts Receivable 1,000 on credit Sales 1,000 Cost of Goods Sold 300 Merchandise Inventory 300 Receiving payment within Cash 980 discount period Sales Discounts 20 Accounts Receivable 1,000 Receiving payment outside Cash 1,000 discount period Accounts Receivable 1,000 Sales Discounts: A contra revenue account, meaning Sales Discounts is subtracted from Sales when computing net sales. Customer Merchandise Returns Entries: Table Summary: First column contains description of transaction. Journal entries with account name and debit amount on initial line, and indented account name and credit amount on following line of

entry. Receiving sales returns of Sales Returns and Allowances 15 nondefective inventory Cash or Accounts Receivable 15 Merchandise Inventory 9 Cost of Goods Sold 9 Sales allowance: A price reduction agreed to when a buyer is unsatisfied with the goods. Recognizing sales Sales Returns and Allowances 10 allowances Cash or Accounts Receivable 10 MERCHANDISER REPORTING Inventory shrinkage: An adjusting entry to account for the loss of inventory due to theft or deterioration. It is computed by comparing a physical count of inventory with recorded amounts. Table Summary: First column contains description of transaction. Journal entry with account name and debit amount on initial line, and indented account name and credit amount on following line of entry. Adjustment for shrinkage Cost of Goods Sold 250 (occurs when recorded amount larger than physical inventory) Merchandise Inventory 250 Closing Entries: Differences between merchandisers and service companies in red. Table Summary: First column contains step number and description of transaction. Journal entries with account name and debit amount on initial line or lines, and indented account name and credit amount on following line or lines of entry. In Step 1, debited account name appears in red print. In Step 2, first three of four credited account names appear in red print. Step 1: Close Credit Balances Sales 321,000 in Temporary Accounts to Income Summary Income Summary 321,000 Step 2: Close Debit Balances Income Summary 308,100 in Temporary Accounts to Sales Discounts 4,300 Income Summary Sales Returns and Allowances 2,000 Cost of Goods Sold 230,400 Other Expenses 71,400 Step 3: Close Income Summary (same entry as for service company) Step 4: Close Withdrawals (same entry as for service company) Multiple-step income statement: Three parts: (1) gross profit; (2) income from operations, which is gross profit minus operating expenses; and (3) net income, which is income from operations plus or minus nonoperating items. Operating expenses: Separated into selling expenses and general & administrative expenses. Selling expenses: Expenses of advertising merchandise, making sales, and delivering goods to customers. General & administrative expenses: Expenses that support a company's overall operations, including accounting and human resources. Nonoperating activities: Consist of expenses, revenues, losses, and gains that are unrelated to a company's main operations. Multiple-Step Income Statement Example Table Summary: Income statement listing elements and amounts used to calculate Gross profit (name in red print), as well as expense accounts and amounts used to determine Income from operations (name in red print) and ultimately Net income (name in red print). Income Statement Sales $321,000 Less: Sales discounts $4,300 Sales returns and allowances 2,000 6,300 Net sales 314,700 Cost of goods sold 230,400 Gross profit 84,300 Operating expenses Selling expenses† General and administrative expenses† Total operating expenses 71,400 Income from operations 12,900 Total other revenues and gains (expenses and losses) 2,000 Net income $ 14,900 †Must list all individual expenses and amounts—see Exhibit 5.13 (not done here for brevity). Single-Step

Income Statement Example Table Summary: Income statement listing Revenues heading (in red print) and Expenses (in red print) with "Total" and amounts below the heading and resulting in Net Income (name in red print) amount. Income Statement Revenues Total revenues* $318,200 Expenses Total expenses* 303,300 Net income $ 14,900 *Must list all individual items and amounts—see Exhibit 5.14 (not done here for brevity).

Key Terms Acid-test ratio (180) Allowance for Sales Discounts (189) Cash discount (167) Cost of goods sold (165) Credit period (167) Credit terms (167) Discount period (168) Discounts Lost (190) FOB (170) General and administrative expenses (178) Gross margin (166) Gross margin ratio (181) Gross method (190) Gross profit (166) Inventory (166) Inventory Returns Estimated (189) Merchandise (165) Merchandise inventory (166) Merchandiser (165) Multiple-step income statement (178) Net method (190) Periodic inventory system (166) Perpetual inventory system (166) Purchases discount (167) Retailer (165) Sales discount (168) Sales Refund Payable (189) Sales Returns and Allowances (173) Selling expenses (178) Shrinkage (175) Single-step income statement (179) Supplementary records (171) Wholesaler (165)

Page 193 Multiple Choice Quiz A company has $550,000 in net sales and $193,000 in gross profit. This means its cost of goods sold equals $743,000. $550,000. $357,000. $193,000. $(193,000). A company purchased $4,500 of merchandise on May 1 with terms of 2/10, n/30. On May 6, it returned $250 of that merchandise. On May 8, it paid the balance owed for merchandise, taking any discount it is entitled to. The cash paid on May 8 is $4,500. $4,250. $4,160. $4,165. $4,410. A company has cash sales of $75,000, credit sales of $320,000, sales returns and allowances of $13,700, and sales discounts of $6,000. Its net sales equal $395,000. $375,300. $300,300. $339,700. $414,700. A company's quick assets are $37,500, its current assets are $80,000, and its current liabilities are $50,000. Its acid-test ratio equals 1.600. 0.750. 0.625. 1.333. 0.469. A company's net sales are $675,000, its cost of goods sold is $459,000, and its net income is $74,250. Its gross margin ratio equals

32%. 68%. 47%. 11%. 34%. ANSWERS TO MULTIPLE CHOICE QUIZ c; Gross profit = $550,000 − $193,000 = $357,000 d; ($4,500 − $250) × (100% − 2%) = $4,165 b; Net sales = $75,000 + $320,000 − $13,700 − $6,000 = $375,300 b; Acid-test ratio = $37,500/$50,000 = 0.75 a; Gross margin ratio = ($675,000 − $459,000)/$675,000 = 32%

QUICK STUDY Superscript letter A, B, or C denotes assignments based on Appendix 5A, 5B, or 5C. Select Quick Study and Exercise assignments feature Guided Example videos, called "Hints" in Connect. Hints use different numbers, and instructors can turn this feature on or off. QS 5-1 Applying merchandising terms C1 P1 Match each phrase with its definition. Sales discount Credit period Discount period FOB destination FOB shipping point Gross profit Merchandise inventory Purchases discount Goods a company owns and expects to sell to its customers. Time period that can pass before a customer's full payment is due. Seller's description of a cash discount granted to buyers in return for early payment. Ownership of goods is transferred when the seller delivers goods to the carrier. Purchaser's description of a cash discount received from a supplier of goods. Difference between net sales and the cost of goods sold. Time period in which a cash discount is available. Ownership of goods is transferred when delivered to the buyer's place of business. QS 5-2 Identifying inventory costsC1 Costs of $5,000 were incurred to acquire goods and make them ready for sale. The goods were shipped to the buyer (FOB shipping point) for a cost of $200. Additional necessary costs of $400 were incurred to acquire the goods. No other incentives or discounts were available. Compute the buyer's total cost of merchandise inventory. QS 5-3 Merchandise accounts and computationsC1 Use the following information (in random order) from a merchandising company and from a service company. Hint: Not all information may be necessary for the solutions. For the merchandiser only, compute (1) goods available for sale, (2) cost of goods sold, and (3) gross profit. Compute net income for each company. McNeil Merchandising Company Accumulated depreciation $ 700 Beginning inventory 5,000 Ending inventory 1,700 Expenses 1,450 Net purchases 3,900 Net sales 9,500 Krug Service Company Expenses $ 12,500 Revenues 14,000 Cash 700 Prepaid rent 800 Accounts payable 200 Equipment 1,300Page 194 QS 5-4 Computing net invoice amountsP1 Compute the amount to be paid for each of the four separate invoices assuming that all invoices are paid within the discount period. Merchandise (gross) Terms Merchandise (gross) Terms a. $5,000 2/10, n/60 c. $75,000 1/10, n/30 b. $20,000 1/15, n/90 d. $10,000 3/15, n/45 QS 5-5 Recording purchases, returns, and discounts takenP1 Prepare journal entries to record each of the following transactions of a merchandising company. The company uses a perpetual inventory system and the gross method. Nov. 5 Purchased 600 units of product at a cost of $10 per unit. Terms of the sale are 2/10, n/60; the invoice is dated November 5. 7 Returned

25 defective units from the November 5 purchase and received full credit. 15 Paid the amount due from the November 5 purchase, minus the return on November 7. QS 5-6 Recording purchases and discounts takenP1 Prepare journal entries to record each of the following transactions. The company records purchases using the gross method and a perpetual inventory system. Aug. 1 Purchased merchandise with an invoice price of $60,000 and credit terms of 3/10, n/30. 11 Paid supplier the amount owed from the August 1 purchase. QS 5-7 Recording purchases and discounts missedP1 Prepare journal entries to record each of the following transactions. The company records purchases using the gross method and a perpetual inventory system. Sep. 15 Purchased merchandise with an invoice price of $35,000 and credit terms of 2/5, n/15. 29 Paid supplier the amount owed on the September 15 purchase. QS 5-8 Recording purchases and returns; no discountsP1 Prepare journal entries to record each of the following transactions. The company records purchases using the gross method and a perpetual inventory system. May 1 Purchased merchandise with a price of $800 and credit terms of n/30. 7 Returned merchandise that had a price of $100. 31 Paid the amount due from the May 1 purchase, minus the May 7 return. QS 5-9 Recording purchases and allowances; no discountsP1 Prepare journal entries to record each of the following transactions. The company records purchases using the gross method and a perpetual inventory system. June 1 Purchased merchandise with a price of $450 and credit terms of n/45. 9 Received a $50 allowance (for scratched merchandise) toward the June 1 purchase. July 16 Paid the amount due from the June 1 purchase, minus the June 9 allowance. QS 5-10 Recording sales, returns, and discounts takenP2 Prepare journal entries to record each of the following sales transactions of a merchandising company. The company uses a perpetual inventory system and the gross method. Apr. 1 Sold merchandise for $3,000, with credit terms n/30; invoice dated April 1. The cost of the merchandise is $1,800. 4 The customer in the April 1 sale returned $300 of merchandise for full credit. The merchandise, which had cost $180, is returned to inventory. 8 Sold merchandise for $1,000, with credit terms of 1/10, n/30; invoice dated April 8. Cost of the merchandise is $700. 11 Received payment for the amount due from the April 1 sale less the return on April 4. QS 5-11 Recording sales and returns; no discountsP2 Prepare journal entries to record each of the following sales transactions of EcoMart Merchandising. EcoMart uses a perpetual inventory system and the gross method. Oct. 1 Sold merchandise for $1,500, with credit terms n/30, invoice dated October 1. The cost of the merchandise is $900. 6 The customer in the October 1 sale returned $150 of merchandise for full credit. The merchandise, which had cost $90, is returned to inventory. 9 Sold merchandise for $700 cash. Cost of the merchandise is $450. 30 Received payment for the amount due from the October 1 sale less the return on October 6.Page 195 QS 5-12 Effects of sales transactions on income statement P2 Analyze each transaction in QS 5-11 by indicating its effects on the components of the income

statement—specifically, identify the accounts and amounts (including + or –) for each transaction. QS 5-13 Recording sales, returns, and allowances; no discounts P2 Prepare journal entries to record each of the following sales transactions of TFC Merchandising. TFC uses a perpetual inventory system and the gross method. May 1 Sold merchandise for $600, with credit terms n/60. The cost of the merchandise is $400. 9 The customer discovers slight defects in some units. TFC gives a price reduction (allowance) and credits the customer's accounts receivable for $40 to compensate for the defects. June 4 The customer in the May 1 sale returned $75 of merchandise for full credit. The merchandise, which had cost $50, is returned to inventory. 30 Received payment for the amount due from the May 1 sale less the May 9 allowance and June 4 return. QS 5-14 Accounting for shrinkage—perpetual systemP3 Telo Company's ledger on July 31, its fiscal year-end, shows merchandise inventory of $37,800 before accounting for any shrinkage. A physical count of its July 31 year-end inventory discloses that the cost of the merchandise inventory still available is $35,900. Prepare the entry to record any inventory shrinkage. QS 5-15 Closing entries P3 Nix'It Company's ledger on July 31, its fiscal year-end, includes the following selected accounts that have normal balances. Nix'It uses the perpetual inventory system. Prepare the company's year-end closing entries. T. Nix, Capital $115,300 T. Nix, Withdrawals 7,000 Sales 170,000 Sales discounts 4,700 Sales returns and allowances 6,500 Cost of goods sold 106,900 Depreciation expense 10,300 Salaries expense 32,500 Miscellaneous expenses 5,000 QS 5-16 Identifying type of income statementP4 Indicate whether each statement describes a multiple-step income statement or a single-step income statement. Commonly reports detailed computations of net sales and other costs and expenses. Statement limited to two main categories (revenues and expenses). Reports gross profit on a separate line. Separates income from operations from the other revenues and gains. QS 5-17 Computing missing amounts using income statement relations P4 Compute the missing amounts in the separate (partial) income statements A, B, and C. QS 5-18 Computing net sales and gross profit P4 Vitamix reports the following information for its year ended December 31: cash sales of $60,000; sales on credit of $90,000; general and administrative expenses of $17,000; sales returns of $11,000; cost of goods sold of $80,000; sales discounts of $2,000; and selling expenses of $24,000. Compute (a) net sales and (b) gross profit. QS 5-19 Preparing gross profit section of a multiple-step income statement P4 Using the year-end information from QS 5-18, prepare the gross profit section of a multiple-step income statement. Page 196 QS 5-20 Preparing a multiple-step income statementP4 Save-the-Earth Co. reports the following income statement accounts for the year ended December 31. Prepare a multiple-step income statement that includes separate categories for net sales, cost of goods sold, selling expenses, and general and administrative expenses. Categorize the following accounts as selling expenses: Sales Staff Salaries Expense and Advertising Expense. Categorize the remaining expenses as

general and administrative. Sales discounts $ 750 Office salaries expense 2,000 Rent expense—Office space 1,500 Advertising expense 500 Sales returns and allowances 250 Office supplies expense 500 Cost of goods sold 9,000 Sales 20,000 Insurance expense 1,000 Sales staff salaries expense 2,500 QS 5-21 Preparing a classified balance sheet for a merchandiserP4 Clear Water Co. reports the following balance sheet accounts as of December 31. Prepare a classified balance sheet. Buildings $25,000 Accounts receivable 2,000 Land 15,000 Merchandise inventory 7,000 Accounts payable 5,000 Cash 8,000 Notes payable (due in 7 years) 30,000 Office supplies 1,000 O. Water, Capital 16,000 Wages payable 3,000 Accumulated Depreciation—Buildings 4,000 QS 5-22 Computing and interpreting acid-test ratioA1 The following information on current assets and current liabilities is for Belkin Company. (a) Compute Belkin's acid-test ratio. (b) If its competitor, Logit, has an acid-test ratio of 1.2, which company is better able to pay for current liabilities with its quick assets? Cash $1,490 Accounts receivable 2,800 Inventory 6,000 Prepaid expenses 700 Accounts payable 5,750 Other current liabilities 850 QS 5-23 Computing and analyzing gross margin ratioA1 (a) Compute net sales, gross profit, and the gross margin ratio for each of the four separate companies. (b) Which company has the best gross margin ratio? Carrier Lennox Trane York Sales $150,000 $550,000 $38,700 $255,700 Sales discounts 5,000 17,500 600 4,800 Sales returns and allowances 20,000 6,000 5,100 900 Cost of goods sold 79,750 329,589 24,453 126,500 QS 5-24A Contrasting periodic and perpetual systemsP5 Identify whether each description best applies to a periodic or a perpetual inventory system. Updates the inventory account only at period-end. Requires an adjusting entry to record inventory shrinkage. Returns immediately affect the account balance of Merchandise Inventory. Records cost of goods sold each time a sales transaction occurs. Provides more timely information to managers. QS 5-25A Periodic: Computing cost of goods soldP5 Chazen Company's inventory balance at the beginning of the year was $6,000. During the year, the company had Purchases of $30,000 and Purchases Returns and Allowances of $2,000. The company's inventory balance at the end of the year is $4,000. Compute cost of goods sold for the year assuming Chazen uses the periodic inventory system. Page 197 QS 5-26A Periodic: Recording purchases, returns, and discounts P5 Refer to QS 5-5 and prepare journal entries to record each of the merchandising transactions assuming that the company records purchases using the gross method and a periodic inventory system. QS 5-27A Periodic: Recording sales, returns, and discounts P5 Refer to QS 5-10 and prepare journal entries to record each of the merchandising transactions assuming that the company records purchases using the gross method and a periodic inventory system. QS 5-28B Recording estimates of future discountsP6 ProBuilder has the following June 30 fiscal-year-end unadjusted balances: Allowance for Sales Discounts, $0; and Accounts Receivable, $10,000. Of the $10,000 of receivables, $2,000 are within a 3% discount period, meaning that it expects buyers to take

$60 in future discounts arising from this period's sales. Prepare the June 30 fiscal-year-end adjusting journal entry for future sales discounts. Assume the same facts above and that there is a $10 fiscal-year-end unadjusted credit balance in the Allowance for Sales Discounts. Prepare the June 30 fiscal-year-end adjusting journal entry for future sales discounts. QS 5-29B Recording estimates of future returnsP6 ProBuilder reports merchandise sales of $50,000 and cost of merchandise sales of $20,000 in its first year of operations ending June 30. It makes fiscal-year-end adjusting entries for estimated future returns and allowances equal to 2% of sales, or $1,000, and 2% of cost of sales, or $400. Prepare the June 30 fiscal-year-end adjusting journal entry for future returns and allowances related to sales. Prepare the June 30 fiscal-year-end adjusting journal entry for future returns and allowances related to cost of sales. QS 5-30C Net method: Recording purchases, returns, and discountsP7 Refer to QS 5-5 and prepare journal entries to record each of the merchandising transactions assuming that the company records purchases using the net method and a perpetual inventory system. QS 5-31C Net method: Recording sales, returns, and discounts P7 Refer to QS 5-10 and prepare journal entries to record each of the merchandising transactions assuming that the company records purchases using the net method and a perpetual inventory system.

	A	B	C
Sales	$?	$20,000	$90,000
Sales discounts	1,500	500	2,000
Sales returns and allowances	4,000	?	7,000
Net sales	35,000	16,500	?
Cost of goods sold	?	14,000	?
Gross profit	13,000	?	21,000

Modes:

Standard

EXERCISES Exercise 5-1 Computing revenues, expenses, and income C1 Fill in the blanks in the following separate income statements a through e. a b c d e Sales $62,000 $43,500 $55,000 $? $25,600 Cost of goods sold Merchandise inventory, beginning 8,000 17,050 7,500 8,000 4,560 Total cost of merchandise purchases 38,000 ? ? 32,000 6,600 Merchandise inventory, ending ? 3,000 9,000 6,600 ? Cost of goods sold

34,050 16,000 ? ? 7,000 Gross profit ? ? 12,750 45,600 ? Expenses 10,000 10,650 12,150 3,600 6,000 Net income (loss) $? $16,850 $ 600 $42,000 $? Exercise 5-2 Operating cycle for merchandiser C1 The operating cycle of a merchandiser with credit sales includes the following five activities. Starting with merchandise acquisition, identify the chronological order of these five activities. Prepare merchandise for sale. Collect cash from customers on account. Make credit sales to customers. Purchase merchandise. Monitor and service accounts receivable. Page 198 Exercise 5-3 Recording purchases, purchases returns, and purchases allowancesP1 Prepare journal entries to record the following transactions for a retail store. The company uses a perpetual inventory system and the gross method. Apr. 2 Purchased $4,600 of merchandise from Lyon Company with credit terms of 2/15, n/60, invoice dated April 2, and FOB shipping point. 3 Paid $300 cash for shipping charges on the April 2 purchase. 4 Returned to Lyon Company unacceptable merchandise that had an invoice price of $600. 17 Sent a check to Lyon Company for the April 2 purchase, net of the discount and the returned merchandise. 18 Purchased $8,500 of merchandise from Frist Corp. with credit terms of 1/10, n/30, invoice dated April 18, and FOB destination. 21 After negotiations over scuffed merchandise, received from Frist a $500 allowance toward the $8,500 owed on the April 18 purchase. 28 Sent check to Frist paying for the April 18 purchase, net of the allowance and the discount. Check Apr. 28, Cr. Cash, $7,920 Exercise 5-4 Purchasing transactions P1 Prepare journal entries to record the following transactions of Recycled Fashion retail store. Recycled Fashion uses a perpetual inventory system and the gross method. Mar. 3 Purchased $1,150 of merchandise from GreenWorld Company with credit terms of 2/15, n/60, invoice dated March 3, and FOB shipping point. 4 Paid $75 cash for shipping charges on the March 3 purchase. 5 Returned to GreenWorld unacceptable merchandise that had an invoice price of $150. 18 Paid GreenWorld for the March 3 purchase, net of the discount and the returned merchandise. 19 Purchased $425 of merchandise from PeopleFirst Corp. with credit terms of 1/10, n/30, invoice dated March 19, and FOB destination. 21 After negotiations, received from PeopleFirst a $25 allowance (for scuffed merchandise) toward the $425 owed on the March 19 purchase. 29 Sent check to PeopleFirst paying for the March 19 purchase, net of the allowance and the discount. Exercise 5-5 Determining inventory ownership and costs in transit P1 For each transaction of Sealy Co., (a) determine whether or not Sealy owns the goods during transit. (b) If Sealy is responsible for transportation costs, record the entry for shipping costs assuming they are paid in cash and the perpetual inventory system is used. Purchased goods FOB shipping point. Transportation costs are $600. Sold goods FOB destination. Transportation costs are $200. Sold goods FOB shipping point. Transportation costs are $350. Purchased goods FOB destination. Transportation costs are $125. Exercise 5-6 Recording sales, sales returns, and sales allowancesP2 Allied Merchandisers was

organized on May 1. Macy Co. is a major customer (buyer) of Allied (seller) products. Prepare journal entries to record the following transactions for Allied assuming it uses a perpetual inventory system and the gross method. May 3 Allied made its first and only purchase of inventory for the period on May 3 for 2,000 units at a price of $10 cash per unit (for a total cost of $20,000). 5 Allied sold 1,500 of the units in inventory for $14 per unit (invoice total: $21,000) to Macy Co. under credit terms 2/10, n/60. The goods cost Allied $15,000. 7 Macy returns 125 units because they did not fit the customer's needs (invoice amount: $1,750). Allied restores the units, which cost $1,250, to its inventory. 8 Macy discovers that 200 units are scuffed but are still of use and, therefore, keeps the units. Allied gives a price reduction (allowance) and credits Macy's accounts receivable for $300 to compensate for the damage. 15 Allied receives payment from Macy for the amount owed on the May 5 purchase; payment is net of returns, allowances, and any cash discount. Exercise 5-7 Effects of sales transactions on income statement P2 Analyze each transaction in Exercise 5-6 by indicating its effects on the income statement—specifically, identify the accounts and amounts (including + or −) for each transaction. Exercise 5-8 Recording purchases, purchases returns, and purchases allowances P1 Refer to Exercise 5-6 and prepare journal entries for Macy Co. to record each of the May transactions. Macy is a retailer that uses the gross method and a perpetual inventory system; it purchases these units for resale. Page 199 Exercise 5-9 Recording sales, purchases, and cash discounts—buyer and seller P1 P2 Santa Fe Retailing purchased merchandise from Mesa Wholesalers with credit terms of 3/10, n/60 and an invoice price of $24,000. The merchandise had cost Mesa $16,000. Assume that both buyer and seller use a perpetual inventory system and the gross method. Prepare entries that the buyer records for the (a) purchase, (b) cash payment within the discount period, and (c) cash payment after the discount period. Prepare entries that the seller records for the (a) sale, (b) cash collection within the discount period, and (c) cash collection after the discount period. Exercise 5-10 Recording sales, purchases, shipping, and returns—buyer and seller P1 P2 Sydney Retailing (buyer) and Troy Wholesalers (seller) enter into the following transactions. Both Sydney and Troy use a perpetual inventory system and the gross method. May 11 Sydney accepts delivery of $40,000 of merchandise it purchases for resale from Troy: invoice dated May 11, terms 3/10, n/90, FOB shipping point. The goods cost Troy $30,000. Sydney pays $345 cash to Express Shipping for delivery charges on the merchandise. 12 Sydney returns $1,400 of the $40,000 of goods to Troy, who receives them the same day and restores them to its inventory. The returned goods had cost Troy $1,050. 20 Sydney pays Troy for the amount owed. Troy receives the cash immediately. Prepare journal entries that Sydney Retailing (buyer) records for these three transactions. Prepare journal entries that Troy Wholesalers (seller) records for these three transactions. Check (1) May 20, Cr. Cash, $37,442 Exercise 5-11 Inventory and cost of sales transactions in T-accounts P1 P2 The

following summarizes Tesla's merchandising activities for the year. Set up T-accounts for Merchandise Inventory and for Cost of Goods Sold. Enter each line item into one or both of the two T-accounts and compute the T-account balances. Cost of merchandise sold to customers $196,000 Merchandise inventory, beginning-of-year 25,000 Merchandise purchases, gross amount 192,500 Shrinkage on inventory as of year-end 800 Transportation-in for merchandise purchases 2,900 Cost of merchandise returned by customers (and restored to inventory) 2,100 Discounts received from suppliers on merchandise purchases 1,700 Returns to and allowances from suppliers on merchandise purchases 4,000 Check Ending Merch. Inventory, $20,000 Exercise 5-12 Recording purchases, sales, returns, and shipping P1 P2 Prepare journal entries for the following merchandising transactions of Dollar Store assuming it uses a perpetual inventory system and the gross method. Nov. 1 Dollar Store purchases merchandise for $1,500 on terms of 2/5, n/30, FOB shipping point, invoice dated November 1. 5 Dollar Store pays cash for the November 1 purchase. 7 Dollar Store discovers and returns $200 of defective merchandise purchased on November 1, and paid for on November 5, for a cash refund. 10 Dollar Store pays $90 cash for transportation costs for the November 1 purchase. 13 Dollar Store sells merchandise for $1,600 with terms n/30. The cost of the merchandise is $800. 16 Merchandise is returned to the Dollar Store from the November 13 transaction. The returned items are priced at $160 and cost $80; the items were not damaged and were returned to inventory. Exercise 5-13 Recording purchases, sales, and returns; no discounts P1 P2 Prepare journal entries for the following merchandising transactions of Powell Company assuming it uses a perpetual inventory system and the gross method. May 1 Powell purchased merchandise with a price of $875 and credit terms of n/30. 12 Powell returned merchandise that had a price of $125. 31 Powell paid the amount due from the May 1 purchase, minus the May 12 return. June 3 Powell sold merchandise for $450, with credit terms n/15. Cost of the merchandise is $300. 5 The customer discovers some of the units are scratched. Powell gives a price reduction (allowance) and credits the customer's accounts receivable for $20 to compensate for the scratches. 18 Powell received payment for the amount due from the June 3 sale less the June 5 allowance. Exercise 5-14 Accounting for shrinkage P3 At the beginning of the year, SnapIt had $10,000 of inventory. During the year, SnapIt purchased $35,000 of merchandise and sold $30,000 of merchandise. A physical count of inventory at year-end shows $14,000 of inventory exists. Prepare the entry to record inventory shrinkage. Page 200 Exercise 5-15 Preparing closing entries for a merchandiser P3 The following listing of temporary accounts is from the December 31 adjusted trial balance of Emiko Co. Use these normal account balances to journalize closing entries. Table Summary: List of accounts in columns 1 and 4 with either a debit amount (column 2 or 5) or a credit amount (column 3 or 6) listed. Cells in columns 3 and 6 are blank, except for column 3 in row 4. In

that same row, column 2 is blank. Debit Credit K. Emiko, Withdrawals $ 33,000 Sales $529,000 Sales returns and allowances 17,500 Sales discounts 5,000 Cost of goods sold 213,300 Table Summary: List of accounts in columns 1 and 4 with either a debit amount (column 2 or 5) or a credit amount (column 3 or 6) listed. Cells in columns 3 and 6 are blank, except for column 3 in row 4. In that same row, column 2 is blank. Debit Credit Sales salaries expense $ 49,700 Utilities expense 15,000 Selling expenses 39,000 Administrative expenses 105,000 Exercise 5-16 Impacts of inventory error on key accounts P3 A retailer completed a physical count of ending merchandise inventory. When counting inventory, employees did not include $3,000 of incoming goods shipped by a supplier on December 31 under FOB shipping point. These goods had been recorded in Merchandise Inventory, but they were not included in the physical count because they were in transit. This means shrinkage was incorrectly overstated by $3,000. Compute the amount of overstatement or understatement for each of the following amounts for this period. Ending inventory Total assets Net income Total equity Exercise 5-17 Computing net sales for multiple-step income statementP4 A company reports the following sales-related information. Compute and prepare the net sales portion only of this company's multiple-step income statement. Sales, gross $200,000 Sales discounts 4,000 Sales returns and allowances 16,000 Sales salaries expense 10,000 Exercise 5-18 Preparing a multiple-step income statementP4 Fit-for-Life Foods reports the following income statement accounts for the year ended December 31. Prepare a multiple-step income statement that includes separate categories for net sales; cost of goods sold; selling expenses; general and administrative expenses; and other revenues, gains, expenses, and losses. Categorize the following accounts as selling expenses: Sales Salaries Expense, Rent Expense—Selling Space, TV Advertising Expense, and Sales Commission Expense. Categorize the remaining expenses as general and administrative. Gain on sale of equipment $ 6,250 Office supplies expense 700 Insurance expense 1,300 Sales 220,000 Office salaries expense 32,500 Rent expense—Selling space 10,000 Sales salaries expense 23,000 Depreciation expense—Office copier 500 Sales discounts 16,000 Sales returns and allowances 4,000 TV advertising expense 2,000 Interest revenue 750 Cost of goods sold 90,000 Sales commission expense 13,000 Exercise 5-19 Preparing a classified balance sheet for a merchandiserP4 Adams Co. reports the following balance sheet accounts as of December 31. Prepare a classified balance sheet. Salaries payable $ 6,000 Buildings 55,000 Prepaid rent 7,000 Merchandise inventory 14,000 Accounts payable 10,000 Prepaid insurance 3,000 Accounts receivable 4,000 D. Adams, Capital 60,000 Notes payable (due in 9 years) 30,000 Office supplies 2,000 Land 22,000 Accumulated depreciation—Building 5,000 Mortgages payable (due in 5 years) 12,000 Cash 16,000 Exercise 5-20 Inventory error impact on ratios A1 Refer to the information in Exercise 5-16 and indicate whether the failure to include in-transit inventory as part of the physical count results in an

overstatement, understatement, or no effect on the following ratios. Gross margin ratio Profit margin ratio Acid-test ratio Current ratio Page 201 Exercise 5-21 Computing and analyzing the acid-test ratio A1 Compute the acid-test ratio for each of the following separate cases. Which company is in the best position to meet short-term obligations? Camaro GTO Torino Cash $2,000 $ 110 $1,000 Short-term investments 50 0 580 Current receivables 350 470 700 Inventory 2,600 2,420 4,230 Prepaid expenses 200 500 900 Total current assets $5,200 $3,500 $7,410 Current liabilities $2,000 $1,000 $3,800Page 202 Exercise 5-22A Periodic: Recording purchases, returns, and allowances P5 Refer to Exercise 5-3 and prepare journal entries to record each of the merchandising transactions assuming that the buyer uses the periodic inventory system and the gross method. Exercise 5-23A Periodic: Recording sales, purchases, and discounts: buyer and seller P5 Refer to Exercise 5-9 and prepare journal entries to record each of the merchandising transactions assuming that the periodic inventory system and the gross method are used by both the buyer and the seller. Exercise 5-24A Periodic: Recording sales, purchases, shipping, and returns: buyer and seller P5 Refer to Exercise 5-10 and prepare journal entries to record each of the merchandising transactions assuming that the periodic inventory system and the gross method are used by both the buyer and the seller. Exercise 5-25B Recording estimates of future discounts P6 Med Labs has the following December 31 year-end unadjusted balances: Allowance for Sales Discounts, $0; and Accounts Receivable, $5,000. Of the $5,000 of receivables, $1,000 are within a 2% discount period, meaning that it expects buyers to take $20 in future-period discounts arising from this period's sales. Prepare the December 31 year-end adjusting journal entry for future sales discounts. Assume the same facts above and that there is a $5 year-end unadjusted credit balance in Allowance for Sales Discounts. Prepare the December 31 year-end adjusting journal entry for future sales discounts. Is Allowance for Sales Discounts a contra asset or a contra liability account? Exercise 5-26B Recording estimates of future returnsP6 Chico Company allows its customers to return merchandise within 30 days of purchase. At December 31, the end of its first year of operations, Chico estimates future-period merchandise returns of $60,000 (cost of $22,500) related to its current-year sales. A few days later, on January 3, a customer returns merchandise with a selling price of $2,000 for a cash refund; the returned merchandise cost $750 and is returned to inventory as it is not defective. Prepare the December 31 year-end adjusting journal entry for estimated future sales returns and allowances (revenue side). Prepare the December 31 year-end adjusting journal entry for estimated future inventory returns and allowances (cost side). Prepare the January 3 journal entries to record the merchandise returned. Exercise 5-27B Recording estimates of future returnsP6 Lopez Company reports unadjusted first-year merchandise sales of $100,000 and cost of merchandise sales of $30,000. Compute gross profit (using the unadjusted numbers above). The company expects future returns and allowances

equal to 5% of sales and 5% of cost of sales. Prepare the year-end adjusting entry to record the sales expected to be refunded. Prepare the year-end adjusting entry to record the cost side of sales returns and allowances. Recompute gross profit using the adjusted numbers from parts 1 and 2. Is Sales Refund Payable an asset, liability, or equity account? Is Inventory Returns Estimated an asset, liability, or equity account? Exercise 5-28C Net method: Recording sales, purchases, shipping, and returns—buyer and seller P7 Refer to Exercise 5-10 and prepare journal entries to record each of the merchandising transactions assuming that the perpetual inventory system and the net method are used by both the buyer and the seller. Exercise 5-29C Net & gross methods: Recording purchases, sales, returns, and discounts—buyer and seller P7 Piere Imports uses the perpetual system in accounting for merchandise inventory and had the following transactions during the month of October. Prepare entries to record these transactions assuming that Piere Imports records invoices (a) at gross amounts and (b) at net amounts. Oct. 2 Purchased merchandise at a $3,000 price ($2,940 net), invoice dated October 2, terms 2/10, n/30. 10 Returned $500 ($490 net) of merchandise purchased on October 2 and debited its account payable for that amount. 17 Purchased merchandise at a $5,400 price ($5,292 net), invoice dated October 17, terms 2/10, n/30. 27 Paid for the merchandise purchased on October 17, less the discount. 31 Paid for the merchandise purchased on October 2.

EXERCISES Exercise 5-1 Calculating income, costs, and revenues C1
Complete the following individual income statements by filling in the blanks.
From A to E. A, B, C, D, E Sales $62,000 $43,500 $55,000 $? $25,600 $
The price of products sold Stock of merchandise, starting with 7,500, 8,000, 17,050, 4,560
Total amount spent on purchasing of goods 38,000 6,600
Inventory of merchandise, ending with 3,000, 9,000, 6,600, etc.
Cost of goods sold 34,050 16,000 What? What? What? 7,000
What is the gross profit? 12,750 45,600? Costs 10,650 10, 000 12,150 3,600 6,000
Net income (loss) $16,850 $? $ 600 $42,000 USD? Exercise 5-
2: Merchandiser's Operating Cycle C1
The following five tasks are part of a merchandiser's credit sales operational cycle. Starting with merchandise acquisition, identify the chronological order of these five activities.
Prepare merchandise for sale. Collect cash from customers on account. Make

Paraphrase without limits.

PROBLEM SET A Problem 5-1A Preparing journal entries for merchandising activities P1 P2
Prepare journal entries to record the following merchandising transactions of Cabela's, which uses the perpetual inventory system and the gross method. July 1 Purchased

merchandise from Boden Company for $6,000 under credit terms of 1/15, n/30, FOB shipping point, invoice dated July 1. 2 Sold merchandise to Creek Co. for $900 under credit terms of 2/10, n/60, FOB shipping point, invoice dated July 2. The merchandise had cost $500. 3 Paid $125 cash for freight charges on the purchase of July 1. 8 Sold merchandise that had cost $1,300 for $1,700 cash. 9 Purchased merchandise from Leight Co. for $2,200 under credit terms of 2/15, n/60, FOB destination, invoice dated July 9. 11 Returned $200 of merchandise purchased on July 9 from Leight Co. and debited its account payable for that amount. 12 Received the balance due from Creek Co. for the invoice dated July 2, net of the discount. 16 Paid the balance due to Boden Company within the discount period. 19 Sold merchandise that cost $800 to Art Co. for $1,200 under credit terms of 2/15, n/60, FOB shipping point, invoice dated July 19. 21 Gave a price reduction (allowance) of $100 to Art Co. for merchandise sold on July 19 and credited Art's accounts receivable for that amount. 24 Paid Leight Co. the balance due, net of discount. 30 Received the balance due from Art Co. for the invoice dated July 19, net of discount. 31 Sold merchandise that cost $4,800 to Creek Co. for $7,000 under credit terms of 2/10, n/60, FOB shipping point, invoice dated July 31. Check July 12, Dr. Cash, $882 July 16, Cr. Cash, $5,940 July 24, Cr. Cash, $1,960 July 30, Dr. Cash, $1,078 Problem 5-2A Preparing journal entries for merchandising activities P1 P2 Prepare journal entries to record the following merchandising transactions of Lowe's, which uses the perpetual inventory system and the gross method. Aug. 1 Purchased merchandise from Aron Company for $7,500 under credit terms of 1/10, n/30, FOB destination, invoice dated August 1. 5 Sold merchandise to Baird Corp. for $5,200 under credit terms of 2/10, n/60, FOB destination, invoice dated August 5. The merchandise had cost $4,000. 8 Purchased merchandise from Waters Corporation for $5,400 under credit terms of 1/10, n/45, FOB shipping point, invoice dated August 8. 9 Paid $125 cash for shipping charges related to the August 5 sale to Baird Corp. 10 Baird returned merchandise from the August 5 sale that had cost Lowe's $400 and was sold for $600. The merchandise was restored to inventory. 12 After negotiations with Waters Corporation concerning problems with the purchases on August 8, Lowe's received a price reduction from Waters of $400 off the $5,400 of goods purchased. Lowe's debited accounts payable for $400. 14 At Aron's request, Lowe's paid $200 cash for freight charges on the August 1 purchase, reducing the amount owed (accounts payable) to Aron. 15 Received balance due from Baird Corp. for the August 5 sale less the return on August 10. 18 Paid the amount due Waters Corporation for the August 8 purchase less the price allowance from August 12. 19 Sold merchandise to Tux Co. for $4,800 under credit terms of n/10, FOB shipping point, invoice dated August 19. The merchandise had cost $2,400. 22 Tux requested a price reduction on the August 19 sale because the merchandise did not meet specifications. Lowe's gave a price reduction (allowance) of $500 to Tux and credited Tux's accounts receivable for that amount. 29 Received Tux's cash payment for the amount due from the

August 19 sale less the price allowance from August 22. 30 Paid Aron Company the amount due from the August 1 purchase. Check Aug. 9, Dr. Delivery Expense, $125 Aug. 18, Cr. Cash, $4,950 Aug. 29, Dr. Cash, $4,300 Problem 5-3A Computing merchandising amounts and formatting income statements C1 P4 Page 203 Valley Company's adjusted account balances from its general ledger on August 31, its fiscal year-end, follows. It categorizes the following accounts as selling expenses: Sales Salaries Expense, Rent Expense—Selling Space, Store Supplies Expense, and Advertising Expense. It categorizes the remaining expenses as general and administrative. Adjusted Account Balances Debit Credit Merchandise inventory (ending) $ 41,000 Other (noninventory) assets 130,400 Total liabilities $ 25,000 K. Valley, Capital 104,550 K. Valley, Withdrawals 8,000 Sales 225,600 Sales discounts 2,250 Sales returns and allowances 12,000 Cost of goods sold 74,500 Sales salaries expense 32,000 Rent expense—Selling space 8,000 Store supplies expense 1,500 Advertising expense 13,000 Office salaries expense 28,500 Rent expense—Office space 3,600 Office supplies expense 400 Totals $355,150 $355,150 Beginning merchandise inventory was $25,400. Supplementary records of merchandising activities for the year ended August 31 reveal the following itemized costs. Invoice cost of merchandise purchases $92,000 Purchases discounts received 2,000 Purchases returns and allowances 4,500 Costs of transportation-in 4,600 Required Compute the company's net sales for the year. Compute the company's total cost of merchandise purchased for the year. Check (2) $90,100 Prepare a multiple-step income statement that includes separate categories for net sales, cost of goods sold, selling expenses, and general and administrative expenses. (3) Gross profit, $136,850; Net income, $49,850 Prepare a single-step income statement that includes these expense categories: cost of goods sold, selling expenses, and general and administrative expenses. (4) Total expenses, $161,500 Problem 5-4A Preparing closing entries and interpreting information about discounts and returns C1 P3 Use the data for Valley Company in Problem 5-3A to complete the following requirement. Required Prepare closing entries as of August 31 (the perpetual inventory system is used). Page 204 Problem 5-5A Preparing adjusting entries and income statements; computing gross margin, acid-test, and current ratios A1 P3 P4 The following unadjusted trial balance is prepared at fiscal year-end for Nelson Company. Nelson Company uses a perpetual inventory system. It categorizes the following accounts as selling expenses: Depreciation Expense—Store Equipment, Sales Salaries Expense, Rent Expense—Selling Space, Store Supplies Expense, and Advertising Expense. It categorizes the remaining expenses as general and administrative. Required Prepare adjusting journal entries to reflect each of the following: Store supplies still available at fiscal year-end amount to $1,750. Expired insurance, an administrative expense, is $1,400 for the fiscal year. Depreciation expense on store equipment, a selling expense, is $1,525 for the fiscal year. To estimate shrinkage, a physical count of ending merchandise inventory is taken. It

shows $10,900 of inventory is still available at fiscal year-end. Prepare a multiple-step income statement for the year ended January 31 that begins with gross sales and includes separate categories for net sales, cost of goods sold, selling expenses, and general and administrative expenses. Check (2) Gross profit, $67,750 Prepare a single-step income statement for the year ended January 31. (3) Total expenses, $106,775; Net income, $975 Compute the current ratio, acid-test ratio, and gross margin ratio as of January 31. (Round ratios to two decimals.)

NELSON COMPANY Unadjusted Trial Balance January 31	Debit	Credit
Cash	$ 1,000	
Merchandise inventory	12,500	
Store supplies	5,800	
Prepaid insurance	2,400	
Store equipment	42,900	
Accumulated depreciation—Store equipment		$ 15,250
Accounts payable		10,000
J. Nelson, Capital		32,000
J. Nelson, Withdrawals	2,200	
Sales		111,950
Sales discounts	2,000	
Sales returns and allowances	2,200	
Cost of goods sold	38,400	
Depreciation expense—Store equipment	0	
Sales salaries expense	17,500	
Office salaries expense	17,500	
Insurance expense	0	
Rent expense—Selling space	7,500	
Rent expense—Office space	7,500	
Store supplies expense	0	
Advertising expense	9,800	
Totals	$169,200	$169,200

SERIAL PROBLEM Serial problem began in Chapter 1. If previous chapter segments were not completed, the serial problem can begin at this point. It is available in Connect with an algorithmic option. Business Solutions P1 P2 P3 P4 SP 5 Santana Rey created Business Solutions on October 1, 2021. The company has been successful, and its list of customers has grown. To accommodate the growth, the accounting system is modified to set up separate accounts for each customer. The following chart of accounts includes the account number used for each account and any balance as of December 31, 2021. Santana Rey decided to add a fourth digit with a decimal point to the 106 account number that had been used for the single Accounts Receivable account. This change allows the company to continue using the existing chart of accounts. Table Summary: Table lists accounts and amounts. Columns 1 and 2 list the account numbers and names. Column 3 has the following blank rows: 16, 18, and 19. Column 4 has the following blank rows: 1 through 15 and 17. No. Account Title Dr. Cr. 101 Cash $48,372 106.1 Alex's Engineering Co. 0 106.2 Wildcat Services 0 106.3 Easy Leasing 0 106.4 IFM Co. 3,000 106.5 Liu Corp. 0 106.6 Gomez Co. 2,668 106.7 Delta Co. 0 106.8 KC, Inc. 0 106.9 Dream, Inc. 0 119 Merchandise inventory 0 126 Computer supplies 580 128 Prepaid insurance 1,665 131 Prepaid rent 825 163 Office equipment 8,000 164 Accumulated depreciation— Office equipment $ 400 167 Computer equipment 20,000 168 Accumulated depreciation— Computer equipment 1,250 201 Accounts payable 1,100 Table Summary: Table lists accounts and amounts. Columns 1 and 2 list the account numbers and names. Column 3 has the following blank rows: 1, 2, 3, 5, and 6. Column 4 has the following blank rows: 4 and 7 through 19. No. Account Title Dr. Cr. 210 Wages payable $ 500 236 Unearned computer services revenue 1,500 301 S. Rey, Capital 80,360 302 S. Rey, Withdrawals $0 403 Computer services revenue 0 413 Sales 0 414 Sales returns and allowances 0 415 Sales discounts 0 502 Cost of goods sold 0 612 Depreciation expense—Office equipment 0 613 Depreciation expense—Computer equipment 0 623 Wages expense 0 637 Insurance expense 0 640 Rent expense 0 652 Computer supplies expense 0 655 Advertising expense 0 676 Mileage expense 0 677 Miscellaneous expenses 0 684 Repairs expense—Computer 0 In response to requests from customers, S. Rey will begin selling computer software. The company will extend credit terms of 1/10, n/30, FOB shipping point, to all customers who purchase this merchandise. However, no cash discount is available on consulting fees. Additional accounts (Nos. 119, 413, 414, 415, and 502) are added to its general ledger to accommodate the company's new merchandising activities. Its transactions for January through March follow. Alexander Image/Shutterstock Jan. 4 The company paid cash to Lyn Addie for five days' work at the rate of $125 per day. Four of the five days relate to wages payable that were accrued in the prior year. 5 Santana Rey invested an additional $25,000 cash in the company. 7 The company purchased $5,800 of merchandise from Kansas Corp. with terms of 1/10, n/30,

FOB shipping point, invoice dated January 7. 9 The company received $2,668 cash from Gomez Co. as full payment on its account. 11 The company completed a five-day project for Alex's Engineering Co. and billed it $5,500, which is the total price of $7,000 less the advance payment of $1,500. The company debited Unearned Computer Services Revenue for $1,500. 13 The company sold merchandise with a retail value of $5,200 and a cost of $3,560 to Liu Corp., invoice dated January 13. 15 The company paid $600 cash for freight charges on the merchandise purchased on January 7. 16 The company received $4,000 cash from Delta Co. for computer services provided. 17 The company paid Kansas Corp. for the invoice dated January 7, net of the discount. 20 The company gave a price reduction (allowance) of $500 to Liu Corp. and credited Liu's accounts receivable for that amount. 22 The company received the balance due from Liu Corp., net of the discount and the allowance. 24 The company returned defective merchandise to Kansas Corp. and accepted a credit against future purchases (debited accounts payable). The defective merchandise invoice cost, net of the discount, was $496. 26 The company purchased $9,000 of merchandise from Kansas Corp. with terms of 1/10, n/30, FOB destination, invoice dated January 26. 26 The company sold merchandise with a $4,640 cost for $5,800 on credit to KC, Inc., invoice dated January 26. 31 The company paid cash to Lyn Addie for 10 days' work at $125 per day. Feb. 1 The company paid $2,475 cash to Hillside Mall for another three months' rent in advance. 3 The company paid Kansas Corp. for the balance due, net of the cash discount, less the $496 credit from merchandise returned on January 24. 5 The company paid $600 cash to Facebook for an advertisement to appear on February 5 only. 11 The company received the balance due from Alex's Engineering Co. for fees billed on January 11. 15 S. Rey withdrew $4,800 cash from the company for personal use. 23 The company sold merchandise with a $2,660 cost for $3,220 on credit to Delta Co., invoice dated February 23. 26 The company paid cash to Lyn Addie for eight days' work at $125 per day. 27 The company reimbursed Santana Rey $192 cash for business automobile mileage. The company recorded the reimbursement as "Mileage Expense." Mar. 8 The company purchased $2,730 of computer supplies from Harris Office Products on credit with terms of n/30, FOB destination, invoice dated March 8. 9 The company received the balance due from Delta Co. for merchandise sold on February 23. 11 The company paid $960 cash for minor repairs to the company's computer. 16 The company received $5,260 cash from Dream, Inc., for computing services provided. 19 The company paid the full amount due of $3,830 to Harris Office Products, consisting of amounts created on December 15 (of $1,100) and March 8. 24 The company billed Easy Leasing for $9,047 of computing services provided. 25 The company sold merchandise with a $2,002 cost for $2,800 on credit to Wildcat Services, invoice dated March 25. 30 The company sold merchandise with a $1,048 cost for $2,220 on credit to IFM Company, invoice dated March 30. 31 The company reimbursed Santana Rey $128 cash for business automobile mileage.

The company recorded the reimbursement as “Mileage Expense.”Page 208 The following additional facts are available for preparing adjustments on March 31 prior to financial statement preparation. The March 31 amount of computer supplies still available totals $2,005. Prepaid insurance coverage of $555 expired during this three-month period. Lyn Addie has not been paid for seven days of work at the rate of $125 per day. Prepaid rent of $2,475 expired during this three-month period. Depreciation on the computer equipment for January 1 through March 31 is $1,250. Depreciation on the office equipment for January 1 through March 31 is $400. The March 31 amount of merchandise inventory still available totals $704. Required Prepare journal entries to record each of the January through March transactions. Post the journal entries in part 1 to the accounts in the company’s general ledger. Note: Begin with the ledger’s post-closing adjusted balances as of December 31, 2021. Check (2) Ending balances at March 31: Cash, $68,057; Sales, $19,240 Prepare a 6-column work sheet (similar to the one shown in Exhibit 3.13) that includes the unadjusted trial balance, the March 31 adjustments (a) through (g), and the adjusted trial balance. Do not prepare closing entries and do not journalize the adjustments or post them to the ledger. (3) Unadj. TB totals, $151,557; Adj. TB totals, $154,082 Page 209 Prepare an income statement (from the adjusted trial balance in part 3) for the three months ended March 31, 2022. (a) Use a single-step format. List all expenses without differentiating between selling expenses and general and administrative expenses. (b) Use a multiple-step format that begins with gross sales (service revenues plus gross product sales) and includes separate categories for net sales, cost of goods sold, selling expenses, and general and administrative expenses. Categorize the following accounts as selling expenses: Wages Expense, Mileage Expense, and Advertising Expense. Categorize the remaining expenses as general and administrative. (4) Net income, $18,833 Prepare a statement of owner’s equity (from the adjusted trial balance in part 3) for the three months ended March 31, 2022. Prepare a classified balance sheet (from the adjusted trial balance) as of March 31, 2022. (6) Total assets, $120,268

TABLEAU DASHBOARD ACTIVITIES Tableau Dashboard Activities expose students to accounting analytics using visual displays. These assignments run in Connect. All are auto-gradable. Tableau DA 5-1 Quick Study, Analyzing credit terms and computing gross profit, C1, P1—similar to QS 5-18 Tableau DA 5-2 Exercise, Analyzing credit terms and computing gross profit, C1, P1—similar to Exercise 5-17 Tableau DA 5-3 Mini-Case, Preparing a classified balance sheet, P1, P4—similar to Exercise 5-19

GENERAL LEDGER General Ledger (GL) Assignments For the following GL assignments, prepare journal entries highlighting the operating cycle of a merchandising company. A trial balance is automatically generated based on the journal entries recorded—this feature can be turned off. GL 5-1 Based on Problem 5-1A GL 5-2 Based on Problem 5-2A GL 5-3 Based on Problem 5-5A

Accounting Analysis COMPANY ANALYSIS A1 AA 5-1 Refer to Apple's financial statements in Appendix A to answer the following. Required Assume that the amounts reported for inventories and cost of sales reflect items purchased in a form ready for resale. Compute the net cost of goods purchased for the year ended September 28, 2019. Compute the current ratio and acid-test ratio as of September 28, 2019, and September 29, 2018. Note: Do not include vendor non-trade receivables with quick assets. Does Apple's 2019 current ratio outperform or underperform the (assumed) industry average of 1.5? Does Apple's 2019 acid-test ratio outperform or underperform the (assumed) industry average of 1.0? COMPARATIVE ANALYSIS A1 AA 5-2 Key comparative figures for Apple and Google follow. Table Summary: Table has a spanner heading for columns 2 and 3 and for columns 4 and 5. Apple Google $ millions Current Year Prior Year Current Year Prior Year Net sales $260,174 $265,595 $161,857 $136,819 Cost of sales 161,782 163,756 71,896 59,549 Required Compute the amount of gross margin and the gross margin ratio for the two years shown for each of these companies. Which company earns more in gross margin for each dollar of net sales for the current year? Does the company's current-year gross margin underperform or outperform the 35% industry average in the case of (a) Apple and (b) Google? Is the change in the company's current-year gross margin favorable or unfavorable for (a) Apple and (b) Google? EXTENDED ANALYSIS A1 P4 AA 5-3 Key comparative figures for Samsung, Apple, and Google follow. $ millions Samsung Apple Google Net Sales $197,691 $260,174 $161,857 Cost of Sales 126,336 161,782 71,896 Required Compute the gross margin ratio for each of the three companies. Is Samsung's gross margin ratio better or worse than that for (a) Apple? (b) Google? Is the single-step or multiple-step income statement format used in the case of (a) Apple, (b) Google, and (c) Samsung?

Page 210 Discussion Questions What items appear in financial statements of merchandising companies but not in the statements of service companies? In comparing the accounts of a merchandising company with those of a service company, what additional accounts would the merchandising company likely use, assuming it employs a perpetual inventory system? Explain how a business can earn a positive gross profit on its

sales and still have a net loss. Why do companies offer a cash discount? How does a company that uses a perpetual inventory system determine the amount of inventory shrinkage? What is the difference between a sales discount and a purchases discount? What is the difference between the single-step and multiple-step income statement formats? Buyers negotiate purchase contracts with suppliers. What type of shipping terms should a buyer attempt to negotiate to minimize transportation costs?

Beyond the Numbers ETHICS CHALLENGE C1 P2 BTN 5-1 Amy Martin is a student who plans to attend approximately four professional events a year at her college. Each event necessitates payment of $100 to $200 for a new suit and accessories. After incurring a major hit to her savings for the first event, Amy develops a different approach. She buys the suit on credit the week before the event, wears it to the event, and returns it the next week to the store for a full refund on her charge card. Required Comment on the ethics exhibited by Amy and possible consequences of her actions. How does the merchandising company account for the suits that Amy returns? COMMUNICATING IN PRACTICE C1 P3 P5 BTN 5-2 You are the financial officer for Music Plus, a retailer that sells goods for home entertainment needs. The business owner, Vic Velakturi, recently reviewed the annual financial statements you prepared and sent you an e-mail stating that he thinks you overstated net income. He explains that although he has invested a great deal in security, he is sure shoplifting and other forms of inventory shrinkage have occurred, but he does not see any deduction for shrinkage on the income statement. The store uses a perpetual inventory system. Required Prepare a brief memorandum that responds to the owner's concerns. Page 211 TEAMWORK IN ACTION C1 BTN 5-3 Official Brands's general ledger and supplementary records at the end of its current period reveal the following. Sales, gross $600,000 Sales returns & allowances 20,000 Sales discounts 13,000 Cost of transportation-in 22,000 Operating expenses 50,000 Merchandise inventory (beginning of period) 98,000 Invoice cost of merchandise purchases 360,000 Purchases discounts received 9,000 Purchases returns and allowances 11,000 Merchandise inventory (end of period) 84,000 Required Each member of the team is to assume responsibility for computing one of the following items. You are not to duplicate your teammates' work. Get any necessary amounts to compute your item from the appropriate teammate. Each member is to explain his or her computation to the team in preparation for reporting to the class. Net sales Total cost of merchandise purchases Cost of goods sold Gross profit Net income Check your net income with the instructor. If correct, proceed to step 3. Assume that a physical inventory count finds that actual ending inventory is $76,000. Discuss how this affects previously computed amounts in step 1. Point: In teams of four, assign the same student a and e. Rotate teams for reporting on a different computation and the

analysis in step 3. ENTREPRENEURIAL DECISION C1 P1 BTN 5-4 Refer to the opening feature about Kendra Scott. Assume the business reports current annual sales at approximately $1 million and prepares the following income statement. KENDRA SCOTT Income Statement For Current Year Ended December 31 Net sales $1,000,000 Cost of sales 610,000 Expenses (other than cost of sales) 200,000 Net income $ 190,000 Assume the business sells to individuals and retailers, ranging from small shops to large chains. Assume that it currently offers credit terms of 1/15, n/60, and ships FOB destination. To improve its cash flow, it is considering changing credit terms to 3/10, n/30. In addition, it proposes to change shipping terms to FOB shipping point. It expects that the increase in discount rate will increase net sales by 9%, but the gross margin ratio (and ratio of cost of sales divided by net sales) is expected to remain unchanged. It also expects that delivery expenses will be zero under this proposal; thus, expenses other than cost of sales are expected to increase only 6%. Required Prepare a forecasted income statement for the next year ended December 31 based on the proposal. Based on the forecasted income statement alone (from your part 1 solution), do you recommend that the business implement the new sales policies? Explain. What else should the business consider before deciding whether to implement the new policies? Explain. Design Element: ©Danil Melekhin/Getty Images